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Combined with THE BANKERS MAGAZINE

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Directors' Responsibilities for Audit and Control

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If a person were to stand on the corner of an average town and ask the first ten people he met "What are the responsibilities of a bank director?", he might get this answer: "To direct the policies of his bank." Many depositors who carry sizable bank balances are led to believe that directors do just that. On the other hand, I have known bank officers who apparently feel that a director's sole function is that of lending his name to an institution for reasons of prestige or new business for the institution.

The duties and responsibilities of directors are substantially the same in national banks and state-chartered organizations, although state laws may differ slightly. These duties, fixed by statute, require a high calibre business or professional person to serve as a director. Major stockholders in some banks frequently find that it is difficult to enlist qualified people who are willing to accept the duties and responsibilities entailed in a directorship.

Banking laws make it clear that the directors are the "masters" and the officers and employees are the "servants" in

L. F. MILLS, Chief Examiner of The Federal Reserve Bank of Missouri, Kansas City, Missouri, has been associated with the bank for 21 years. In this article Mr. Mills stresses the importance of directors taking their duties seriously, and outlines the consequences for those who do not. Among the subjects he discusses are the responsibilities of the directors regarding: investments, personnel, capital, and trusts, as well as the banks' policies and operations.

a banking institution. This is particularly true when no officer is a director. However, in most instances one or more of the officers are directors and major stockholders, an arrangement which seems to result in a smoother operation.

Selection of a bank's management and personnel is one of the director's most important tasks. It calls for definite policies coupled with careful follow-through. The board of directors should formulate long-range plans for the continuity of management, a system which can be accomplished by training promising junior officers capable of assuming heavier duties when the need arises. The directors must never permit an officer to perpetuate his tenure of office by failing to train one or more men to assume his duties should it become necessary. To be primarily dependent on one man is a hazardous situation.

Since many statutes require that the directors approve or disapprove all loans and advances, it is important that the board fix definite policies in this area of operation. Included in this responsibility are the total volume of loans a bank may carry, as well as the limitations on loan totals for unsecured loans, real estate loans, consumer credit, cattle loans and the like.

Loan policy responsibility also includes the fixing of authority to extend credit by the managing officers, acting on either their own judgment or with the approval of a discount committee. When setting such limitations, the directors should be familiar with the economic life of the community. They should also have a general knowledge of their bank's deposits, from a standpoint of stability and seasonal fluctuations, and they should know the amount represented by unusually large accounts and public funds, which may be of a temporary nature. The directors must also be familiar with time and savings accounts.

Since the investment portfolio is usually considered a secondary reserve, it is extremely important that the directors set up policies governing the purchase of bonds and investment securities. Complete knowledge of the seasonal demand for loans by regular customers, as well as a familiarity with possible

deposit fluctuations, is of chief importance in establishing an investment program.

Other factors concerned with investments include: (1) limitations imposed by banking laws and regulations under which the bank operates; (2) the quality of proposed investments; (3) liquidity; (4) the maturities of longer-term bonds to be purchased and the possibility of market fluctuation; (5) security types and credit information, so that the directors can appraise the obligors adequately; and (6) diversification and the avoidance of concentrations.

CAPITAL

A director must also be fully informed about the capital position of his bank, including the capital cushions, if any, in the form of reserves, and the undivided profits account. If the bank is in a weak capital position when the volume and type of business are considered, it is obvious that the directors' responsibilities are increased.

Directors must also assume the responsibility for seeing that the bank has an adequate capitalization and for deciding whether this situation should be accomplished by the sale of new stock or by the conservation of earnings. The declaration of dividends is wholly the responsibility of the directors, who are subject to penalty if certain statutory limitations governing the payment of these dividends are not observed. The directors are also subject to severe penalty if a dividend is paid when the bank is in default of assessment payments levied by the FDIC.

TRUSTS

If a bank enters the trust business, the directors' responsibilities are increased in proportion to the amount of business acquired. Too often, unfavorable court decisions reached in settling claims against corporate fiduciaries in the handling of trusts and estates point up the importance of the directors' responsibility.

As I pointed out previously directors' responsibilities in state and national banks are for the most part the same, with

some minor differences in the statutory duties. Of special interest to members of national banks is a 30-page bulletin issued by the Comptroller of the Currency entitled "Duties and Liabilities of Directors of National Banks," Treasury Department form number 1417.

In establishing operating policies for the bank, the directors overlook some of their responsibilities if they do not include some of the safeguards advocated by NABAC and other supervisory agencies. Such safeguards include: (1) every officer and employee of a bank should be required to take a vacation for a reasonable period each year; (2) adequate fidelity insurance should be provided; (3) rotate key employees; (4) pay adequate salaries at all levels commensurate with the bank's earnings; and (5) operate a workable system of internal audits. Such safeguards can be observed in small banks as well as in large institutions and several country banks are currently following these suggestions.

SERVICE

Because banking is vested with public interest, it is subject to legislative control. The public, without the protection afforded by law, would soon see a repetition of the situation that existed during and after World War I. That is, a bank on every corner, and two at each crossroads junction. If this were to happen the people would again feel the impact of wholesale failures and mergers.

To preserve the *privately-owned* banking system, all bank directors, officers, and employees should remember that the bank must willingly provide the community with ample banking service. It is one of the directors' responsibilities to see that their bank does just that.

Too frequently, supervisory agencies hear complaints that a certain bank is not serving the community properly, and in some cases the complaints were found to be justified.

In one instance, a good-sized town, with considerable business activity, had only one bank and the people of the town felt they needed another. Instead of the usual "Can't borrow any

money" complaint, people claimed that the bank's lobby space was too small, that there were too few tellers, long waiting lines for customers, and that the bank levied exorbitant service charges. When the owners and management were advised of these complaints, they made the changes necessary to correct the situation. A charter for a new bank was not granted.

QUALIFICATIONS

Directors' responsibilities vary with the community. However, if the board members do not have the qualifications and initiative to perform their duties, both the bank and the community may suffer. While the directors, who are not active officers, need not know the detailed techniques of bank operations, they should possess good business judgment and the independence to speak and act accordingly. It is important, however, that an able leader be selected as board president or chairman, to lend "know-how" to the work of the group.

In addition to the duties and responsibilities stated and implied by statute, directors may give advice and counsel to the managing officers. It is often advantageous to have as members of the board representatives of various businesses and professions. An organization of this kind can keep management better informed on conditions in the trade area and provide valuable assistance in establishing lines of credit and various operating policies.

THE COURTS

In past years, courts of law have placed directors in the same category as bank officers, in permitting a bank to operate when that organization is in a failing condition. Severe penalties have been incurred, particularly when certain violations were involved, such as loans granted in excess of the statutory limitations and the payment of dividends when earnings should have been used to remove losses.

Deposit insurance does not absolve the director from his responsibilities, although such insurance has generally pacified the majority of people. The FDIC is authorized to lend needed financial assistance to an insured bank, which can be of

great help to a board of directors operating under trying circumstances.

Bankers are fully aware that defalcations have been increasing. Supervisory agencies cannot solve this ugly problem alone. Staffing these agencies adequately to tackle the job would be a project too costly for the banks. And it is doubtful that the agencies, fully staffed, could achieve satisfactory results. This is a problem calling for the cooperative effort of everyone connected with the banking field, including the bank directors, who bear the responsibility for managing the affairs and the business of their bank.

BANKING DECISIONS

In this department are published each month all of the important decisions of the Federal and State Courts involving questions pertaining to the law of banking and negotiable instruments. The experiences they disclose deserve careful attention and study of bankers, bank counsel, the depositor and the bank student seeking advancement.

State Court Lacks Jurisdiction in National Bank Case

Apparently the contest between the Bank of Livonia and the National Bank of Detroit which gained great prominence in Michigan banking circles has ended. The Livonia bank was granted permission by the State Bank Commissioner to open a branch in an industrial section of Livonia and the National Bank of Detroit was granted similar permission by the Comptroller of the Currency in Washington. The Livonia bank then won the race to get into operation first and then sought through the State Banking Commissioner to stop the establishment and operation of the Detroit Bank. Suit was brought by the Commissioner in the Michigan Supreme Court against the Detroit Bank but the court refused the relief asked for on grounds that it had no jurisdiction to settle the matter.

Specifically the court ruled if the establishment of the national bank after the establishment of the state bank in the same area was a violation of law, it was a violation of federal not state law because Congress has the sole power to regulate national banks and has not delegated any of this power to the states. *Millard, Attorney General et al v. National Bank of Detroit,* Supreme Court of Michigan, 61 N.W.2d 804. The opinion of the court is as follows:

DETHMERS, C. J.—This is *quo warranto* brought here to challenge the right of defendant National Bank of Detroit to establish and operate a branch at 27637 Grand River avenue in the City of Livonia. The case

is submitted on pleadings and stipulation of facts going to the merits and defendant's motion to dismiss for lack of jurisdiction.

Plaintiffs allege that relator Bank of Livonia, a State bank, was in operation in Livonia when defendant established the branch in question there. They contend that, accordingly, defendant was precluded therefrom by the following statutory provisions:

> "The conditions upon which a national banking association may retain or establish and operate a branch or branches are the following: . . .
>
> "(c) A national banking association may, with the approval of the Comptroller of the Currency, establish and operate new branches: (1) Within the limits of the city, town or village in which said association is situated, if such establishment and operation are at the time expressly authorized to State banks by the law of the State in question; and (2) at any point within the State in which said association is situated, if such establishment and operation are at the time authorized to State banks by the statute law of the State in question by language specifically granting such authority affirmatively and not merely by implication or recognition, and *subject to the restrictions as to location imposed by the law of the State on State banks.*" 12 U.S.C.A. § 36.
>
> "Any bank having a capital of at least $50,000.00 may, with the written approval of the commission, establish and operate a branch or branches within a village or city other than that in which it was originally chartered: Provided, That the village or city in which it is proposed to establish and operate a branch is located in the same county in which the parent bank has its principal office or, if not in said county, then within 25 miles of said parent bank or in a contiguous county at a point more than 25 miles from the parent bank, if such county has no bank:
>
> *Provided further, That no such branch shall be established in a city or village in which a state or national bank or branch thereof is then in operation: . . .*" Mich.C.L.1948, § 487.34, Stat.Ann. 1951, Cum.Supp. § 23.762.

Touching this court's jurisdiction, defendant cites First National Bank in St. Louis v. State of Missouri, 263 U.S. 640, 44 S.Ct. 213, 68 L.Ed. 486; Territory v. Lockwood, 3 Wall. 236, 18 L.Ed. 47; Ex parte Shockley, D.C.Ohio, 17 F.2d 133; and People ex rel. Trombley v. Humphrey, Auditor General, 23 Mich. 471, for the proposition that State courts have no authority or jurisdiction, by *quo warranto* or otherwise, to call a Federal corporation or officer to account for acts alleged to be in excess of powers granted by, or for alleged violations of, Federal law. Conceding the validity of that proposition, plaintiffs urge its inapplicability on

the ground that presented here is a question of violation of State rather than Federal law, citing as authority for that contention and for the right of enforcement and vindication of State law by State courts against agencies constitutionally created by Federal law, Attorney General v. First Nat. Bank of Bay City, 192 Mich. 640, 159 N.W. 335, reviewed in First Nat. Bank of Bay City v. Fellows ex rel. Union Trust Co., 244 U.S. 416, 37 S.Ct. 734, 61 L.Ed. 1233; First Nat. Bank in St. Louis v. State of Missouri, supra; Ex parte Worcester County Nat. Bank, 279 U.S. 347, 49 S.Ct. 368, 73 L.Ed. 733; and Anderson Nat. Bank v. Luckett, 321 U.S. 233, 64 S.Ct. 599, 88 L.Ed. 692.

First National Bank of Bay City involved, as stated in the report of that case, "the validity of provisions in the Federal Reserve Bank Act authorizing national banks to act as trustees, etc., when allowed by the Reserve Board and *not in contravention of state law;* also the jurisdiction of the State court to determine the authority of such banks in proceedings akin to *quo warranto.*" Worcester County National Bank involved a like situation and statutory provision. It was held in Worcester that the act of congress, 12 U.S.C.A. § 34a, limiting national banks in certain respects to acts not "in contravention of the law of the state" enjoins upon the federally created corporation "complete conformity with the state law" (syl.) and in Bay City that in so doing "Congress impliedly, if not expressly, authorized the institution and conduct in the state supreme court of proceedings in the nature of *quo warranto* to test whether the exercise of such function by a national bank is consistent with the state law. (syl.)" First National Bank in St. Louis was decided at a time (1923) when Federal law made no provision for establishment of branches by national banks. The Supreme Court of the United States held that enforcement of the State act, theretofore construed by the State Supreme Court to prohibit national as well as State banks from establishing branches, constituted a valid exercise of State power and that national banks were subject thereto because it did not "interfere with the purposes of their creation, tend to impair or destroy their efficiency as federal agencies, or conflict with the paramount law of the United States" [263 U.S. 640, 44 S.Ct. 215]; and, further, that "since the sanction behind it (the State act) is that of the state and not that of the national government, the power of enforcement must rest with the former and not with the latter." Anderson National Bank, in which jurisdiction of the State court was not questioned, was of the same import as St. Louis to the effect that a State could make applicable to national banks a law providing for the administration of abandoned bank deposits so long as that was not in conflict with any Federal law.

To summarize the holdings of the above cases, it appears that when, as in St. Louis and in Anderson, there is no Federal law governing the subject and the State act undertaking to do so in no wise conflicts with

paramount Federal law or with the purposes for which the federally created agency was established, the latter is subject to the State law and enforcement thereof in the State courts; and that when, as in Bay City and in Worcester, congress has expressly delegated to the States the power to legislate in the field and the States have done so, then, as said in St. Louis, the State courts may enforce the applicable law because in so doing they are not enforcing Federal but State law and, as said in Bay City, in leaving the matter to be governed by the State law congress has impliedly conferred upon State courts the power to enforce it.

Unlike St. Louis and Anderson, in the instant case there is Federal law governing the subject matter. The National Bank Act provides for and governs the establishing of branches by national banks. It has left no area to be occupied by a State statute covering that subject. The case at bar is distinguishable from Bay City and Worcester in which congress delegated to the States the power to legislate on the subject there in question by providing that the federally created corporations might act in certain respects only when "not in contravention of state law." Here congress has not delegated to the States power to enact legislation forbidding or governing the establishment of branches by national banks. Rather the act of congress has fixed and set the standard by which it must be determined whether a national bank may establish a branch, namely, whether State law permits it to be done by State banks. Violation of the standard offends against Federal, not State, law, for how can a national bank be guilty of violating a restriction imposed by State law on State banks. Clearly distinguishable is the situation, as in Bay City and Worcester, in which the act of congress provides for a course of action by a Federal agency when and if it is not prohibited by State law, for in such case it is the State law, while in the instant case it is the act of congress, which either permits or prohibits the action in question.

Not only does the prohibitory State statute here involved (part of an act providing for the incorporation, operation and regulation of State banks) make no express mention of national banks but, if it were deemed to have been the legislative intent to make its restrictions on branches applicable to national banks, it would in that respect fail for the reason that the act of congress has preempted the field.

May defendant establish and operate the branch? The answer is to be found in Federal law which governs and employs State law as a measuring stick for its application. The suit being for enforcement of Federal law against a federally created corporation, this court is without jurisdiction in the premises.

The information and relations are dismissed, with costs to defendant.

BOYLES, J., concurred in result.

Tax on Branch of National Bank Held Void

Under a federal statute states may tax "all the shares of national banking associations located within its limits." A general Georgia statute follows the provisions of the federal law and provides that only shares of stockholders of national banks may be taxed. But another part of the Georgia statutes provides that "Branch banks shall be taxed on the value of the capital employed in their operation." When a county tax authority attempted to collect taxes on branch banks of the Citizens and Southern National Bank based on this branch bank statute, the bank sought an injunction. The court ruled in favor of the bank on grounds that the part of the statute taxing capital of branch banks violated both the federal statute and the general state statute which permitted taxation only on the shares of such banks. *Goodwin v. Citizens & Southern National Bank,* Supreme Court of Georgia, 76 S.E.2d 620. The opinion of the court is as follows:

Syllabus by the Court.

1. The State can lawfully tax national banks only as provided by Federal law. 12 U.S.C.A. § 548.

2. By Code, § 92-2406, Georgia has elected to adopt the method of taxing shares of stockholders of national banks as provided by Federal law and, hence, as provided in the Federal statute, cannot adopt any of the other alternative methods of taxation.

3. The abortive attempt by Code, § 92-2406 to tax branch national banks on the capital employed therein cannot be construed to mean taxation of the shares of stockholders, and, being in violation of the Federal statute and in contradiction of the portion of the same section which forbids taxation of banks is void.

4. The assessment of Richmond County against the Augusta branches of Citizens and Southern National Bank, as provided in the foregoing void statute, was illegal, and the petition of the bank seeking to enjoin the enforcement of that assessment and to declare it void was not subject to general demurrer.

5. Previous voluntary returns and payment of taxes by the branch bank, as provided in State law but contrary to the Federal statute, do

NOTE—For similar decisions see B. L. J. Digest (Fifth Edition) §1504.

not estop the bank from maintaining an action to prevent taxing authorities from requiring payment of taxes contrary to the Federal law.

Citizens and Southern National Bank, the defendant in error, filed a petition in three counts against J. Bland Goodwin, as Tax Collector of Richmond County, Georgia, the plaintiff in error, to declare null and void the assessment of taxes for the year 1952, to cancel such assessment, and to enjoin the collection of such taxes. A temporary restraining order was granted, restraining any further action against the petitioner for the collection or issuance of any execution for the collection of the tax. Count I alleges that the assessment was made upon the bank's capital, surplus, undivided profits, and personal property, in violation of congressional permission, 12 U.S.C.A. § 548, and of certain specified sections of the Constitutions of Georgia and the United States, in that the assessment constituted the levy of a direct tax upon the capital of a national banking association rather than a tax on its shares. Count II alleges that the assessment was made as shown above beyond the purview of Code, § 92-2406, was in violation of congressional permission (see above), and in violation of certain specified sections of the Constitutions of Georgia and the United States, in that the assessment constituted the levy of a direct tax upon the capital of a branch of a national banking association rather than a tax on its shares, while the only situs for taxation of the petitioner was fixed by its charter issued by the Comptroller of the Currency. Count III alleges that the assessment is at a higher value than similar property in Richmond County, in that the custom in that county was to assess the capital of banks on the basis of 50% of its true value and the assessment here is more than 70%, thereby constituting discrimination in violation of certain specified sections of the Constitutions of Georgia and the United States. Tender of the amount of tax which would be due if taxable at all on a proper valuation was made by the bank.

General and special demurrers were filed to each count of the petition and, after a hearing, the court below issued an order overruling each and every demurrer. The exceptions here are to this judgment.

Franklin H. Pierce, Augusta, Eugene Cook, Atty. Gen., M. H. Blackshear, Deputy Asst. Atty. Gen., F. H. Boney, Asst. Atty. Gen. W. Dan Greer, Atlanta, for plaintiff in error.

Fulcher, Fulcher & Hagler, Augusta, Alston, Sibley, Miller, Spann & Schackelford, Atlanta, for defendant in error.

DUCKWORTH, C. J.—1. Whether the assessment here is against the bank or against its shareholders, the bank is entitled to maintain a suit in equity in its own name to prevent an unlawful assessment. Pelton v. National Bank, 101 U.S. 143, 25 L.Ed. 901; Hills v. National Albany

Exchange Bank, 105 U.S. 319, 26 L.Ed. 1052. Since a national bank is an instrumentality of the Federal government, the States are without power to tax such banks in the absence of consent of the Congress. Owensboro National Bank v. Owensboro, 173 U.S. 664, 19 S.Ct. 537, 43 L.Ed. 850. Such congressional consent is given in 12 U.S.C.A. § 548, and is sharply constricted as follows: "The legislature of each State may determine and direct, subject to the provisions of this section, the manner and place of taxing all the shares of national banking associations located within its limits. The several States may (1) tax said shares, or (2) include dividends derived therefrom in the taxable income of an owner or holder thereof, or (3) tax such associations on their net income, or (4) according to or measured by their net income, provided the following conditions are complied with"; and it is further provided by the Federal statute that when the State has adopted one of the four plans, it will not be allowed to impose any of the other methods of taxation. The provision of our Code, § 13-203, defining rules applicable to branch banks and investing the superintendent of banks with authority to make the ultimate decision as to compliance with such rules, was obviously intended to apply only to State banks, because (1) it vests in the superintendent of banks powers which he cannot exercise with reference to national banks; and (2) Code, § 13-201 plainly states that the provisions of chapter 13 shall not apply to national banks unless expressly so provided.

Therefore we must look solely to the 1927 general tax act, Code, § 92-2406; Ga.L. 1927, p. 99, § 11, for the State law relating to taxing national branch banks. That section begins with the positive statement that "No tax shall be assessed upon the capital of banks or banking associations organized under the authority of this State or the United States located within this State, but the shares of the stockholders of the banks or banking associations, whether resident or nonresident owners, shall be taxed in the county where the banks or banking associations are located, and not elsewhere". It is important to observe that shares alone are taxable, and banks are not, and this can be done only in the county where the bank is located. This much of the State tax act is in complete accord with the Federal law which gives consent and upon which the State is wholly dependent for authority to tax at all.

But when the State in the same section undertakes to tax branch banks, there is no attempt to conform to the Federal statute. The State law there provides that "Branch banks shall be taxed on the value of the capital employed in their operation," thus providing for taxing "branch banks" and fixing the basis therefor as "the value of the capital employed in their operation," which clearly contradicts the first portion of the section that says banks shall not be taxed, and that means their capita, but shares of the stockholders alone may be taxed.

Of course the legislature intended to tax branches of national banks, and this intent is obvious, but it is equally obvious that it did it in a manner forbdden by Federal law. Manifestly, the legislature was familiar with the Federal statute and its limitations upon the scope of permissible taxation by the States as evidenced by the provision that no bank shall be taxed but only shares of stockholders. Failure of the legislature so to provide with reference to branch banks, though due to mistake or any cause, despite an intention to tax is fatal. When the 1927 amendment of the banking act, Ga.L.1927, p. 195, is read, it will be found that section one is a comprehensive outline for operating branch State banks, empowering the State Superintendent of Banks to enforce its provisions, and then follows a provision for taxing such branch banks, which is the exact verbiage of the portion of the 1927 general tax act relating to taxing branch banks. It is evident that, when writing the tax act relating to branch banks, the legislature simply lifted what had been written into the banking act and inserted into the taxing act. This would have been entirely all right had the tax act been limited, as was the banking act, to Georgia banks, but it simply does not fit into the Federal law and, hence, cannot be applied to national branch banks.

The District Court opinion in Citizens & Southern National Bank v. City of Atlanta, D.C., 46 F.2d 88, 90, holding that the Georgia law providing for taxing national branch banks on the value of the capital allocated to them meant taxing shares of stockholders, was written by Judge Sibley. He states that "The loose language is due to the loose Georgia doctrine on the subject." The Georgia doctrine was then and is now that all ambiguous or loose tax laws must be construed against the government and in favor of the taxpayer, and not contrariwise. Mayor, etc., of City of Savannah v. Hartridge, 8 Ga. 23; State v. Camp, 189 Ga. 209, 6 S.E. 2d 299; Forrester v. Interstate Hosiery Mills, 194 Ga. 863, 23 S.E. 2d 78; Thompson v. Eastern Air Lines, Inc., 200 Ga. 216, 39 S.E.2d 225. This is the Federal rule also. See Burnet v. Willingham Loan & Trust Co., 282 U.S. 437, 51 S.Ct. 185, 75 L.Ed. 448. This rule forbids any construction by implication. Mystyle Hosiery Shops v. Harrison, 171 Ga. 430, 155 S.E. 765; Publix-Lucas Theatres v. City of Brunswick, 206 Ga. 206, 56 S.E.2d 254.

When he became a member of the Circuit Court of Appeals, Judge Sibley wrote the opinion in Gully v. First Nat. Bank in Meridian, 5 Cir., 81 F.2d 502, wherein he cited First National Bank of Gulfport v. Adams, 258 U. S. 362, 42 S.Ct. 323, 66 L.Ed. 661, and held that an assessment against a bank upon its capital, surplus, and undivided profits was an assessment, not against the shares of the stockholders, but was against the bank, and offended the Federal law permitting States to tax shares of national banks, and was void. Although Judge Sibley did not mention

his former contrary opinion, it is clear that he had concluded that it was unsound because he did not follow it.

The assessment in the instant case is, in substance, the same as that held to be void by the circuit court. The assessment conforms to the State law which is void for the same reason.

The cases of Georgia State Building & Loan Assn. v. City of Savannah, 109 Ga. 63, 35 S.E. 67, and Daniel v. Bank of Clayton County, 154 Ga. 282, 114 S.E. 210, involved banks and not branch banks. Therefore the portion of Code, § 92-2406 applicable does plainly tax shares and forbids taxing the banks. We are here dealing not with banks but with branch banks to which the provisions of Code, § 92-2406 apply differently, and, hence, the above decisions are entirely inapplicable here.

The words, "Branch banks shall be taxed" are unambiguous, and the words, "on the value of the capital employed", are also unambiguous. The quoted words constitute the heart of Code, § 92-2406 as it applies to branch banks. While being unambiguous and, hence, not subject to construction, yet if they would possibly bear a construction that would cause them to mean "branch banks shall not be taxed but shares representing the amount of capital devoted to their use shall be taxed", we would be compelled to construe them against the government and favorably to the taxpayer, which would mean accepting the literal words in preference to a construction favoring taxation.

We believe we have demonstrated that, although empowered by Federal law to do so, Georgia has enacted no valid law for taxing shares of stockholders of national branch banks. For this reason the petition to enjoin the assessment here against the branch national bank is not subject to demurrer.

But it is contended that, by its voluntary return for taxes and the tender of an amount alleged to be the amount of taxes due, the bank is estopped to now challenge the right of the county to tax. We reject this contention because any payment would offend the Federal law. The bank is an instrumentality of the Federal government, is subject to Federal law, and no violation of that law will work an estoppel that will require or justify further violations. Both the county and the bank are charged with knowledge of the Federal law, and failure of the State law to conform to the requirements of the Federal law. There is no estoppel here. See Bibb Nat. Bank of Macon v. City of Macon, 148 Ga. 478, 97 S.E. 72.

For the reasons set forth in the foregoing opinion, the court did not err in overruling the demurrers.

Judgment affirmed.

All the Justices concur, except ATKINSON, P. J., not participating.

Prior Suit Against Payee to Cancel Note Does Not Prevent Suit by Holder

Two important legal points have been decided in a Texas court. Stanley gave a $37,000 note to Daniels who immediately endorsed the note to a bank as collateral security for a $15,000 debt she owed the bank. On July 19th, Stanley sued Daniels but not the bank in County A to cancel the note. On July 3d, the bank sued Stanley in County B to collect the note which had been accelerated by nonpayment. Stanley appeared in the latter case and claimed the suit there should be stopped because he was suing Daniels in County A to have the note canceled on grounds of fraud.

The court ruled in favor of the bank and made these two findings: First, the suit in County A to cancel the note did not bar the bank's later suit in County B because the bank had not been made a party to the County A suit and thus could not be affected by a decision there. Second, the bank could recover only $15,000, the amount of Daniels debt to it, since it is settled law that where there is a valid defense against an original payee, one holding a negotiable note as collateral security can recover only the amount of the debt received. *Stanley et ux v. Columbus State Bank,* Court of Civil Appeals of Texas, 258 S.W.2d 840. The opinion of the court is as follows:

BOYD, J.—On May 17, 1952, appellants Lincoln H. Stanley and wife, as part consideration for the purchase of an 18-acre tract on which was situated a motel, executed and delivered to Mrs. Monetta V. Daniels a note in the principal sum of $37,722.50, bearing interest from date at five per cent per annum, and at ten per cent per annum after maturity, due in monthly installments of $400.13, beginning July 1, 1952, with accelerated maturity and ten per cent attorney's fees clauses, and secured by vendor's and deed of trust liens on said property. Mrs. Daniels immediately endorsed and assigned the note and liens to appellee Columbus State Bank as collateral security for a note owed by her to the bank in the principal sum of $15,500, dated May 17, 1952, bearing interest from date at five per cent per annum, providing for ten per cent attorney's fees, and due in sixty days.

On June 19, 1952, appellants filed suit in the 133rd District Court of Harris County against Mrs. Daniels, Cause No. G407011, for cancella-

tion of the $37,722.50 note and the liens on the ground of fraud in their procurement, and in the alternative for damages. On July 3, 1952, appellee Bank filed suit in the District Court of Colorado County against appellants for the principal, interest and attorney's fees on said note and for foreclosure of the liens. Appellants filed their original answer in the Colorado County suit on August 22, 1952, being a general denial. Appellants' amended answer filed on September 12, 1952, contained special exceptions, a general denial, and a special answer alleging that the instruments declared upon were procured by fraud and that appellee had knowledge of the fraud at the time it became the holder of the note. Such knowledge was denied by the Bank. Appellants filed a second amended answer on September 24, which consisted of a plea in abatement setting up the pendency of the Harris County suit, special exceptions, general denial, and special answer as in the first amended answer. On September 25, the plea in abatement was heard and overruled, and the cause on its merits was tried before the court on September 26, resulting in a judgment for appellee against appellants for $42,233.73, with interest from that date at ten per cent per annum, and for foreclosure of the vendor's lien and deed of trust lien on the property. This is an appeal from that judgment.

Appellants' first point is that the court erred in overruling the plea in abatement. The question as to whether the pendency of another cause will abate a suit involving the same subject matter and between substantially the same parties has been many times before our courts, and before the decision by the Supreme Court in Cleveland v. Ward, 116 Tex. 1, 285 S.W. 1063, there was a lack of uniformity in the holdings. In some cases it was held that the common-law doctrine that a pending suit between two parties would abate a second suit between the same parties on the same cause of action was not the rule in Texas. Garza & Co. v. Jesse French Piano & Organ Co., 59 Tex. Civ. App. 590, 126 S.W. 906; Liberty Milling Co. v. Continental Gin Co., Tex. Civ. App., 132 S.W. 856; Cole v. State ex rel. Cobolini, Tex. Civ. App., 163 S.W. 353; Hartzog v. Seeger Coal Co., Tex. Civ. App., 163 S.W. 1055. The plea of another action pending has been held to be unavailing where the plaintiff in one suit was the defendant in the other. McCoy v. Bankers' Trust Co., Tex. Civ. App., 200 S.W. 1138, citing 1 C.J., p. 82, and Standard Encyc. of Proc., p. 1018. See, also, 1 C.J.S., Abatement and Revival, § 61. In some cases where the common-law doctrine has been recognized as in force in Texas, the courts have refused to apply it where one suit was for debt and foreclosure and the other was a suit to cancel the debt and lien. Garza v. Sullivan, Tex. Civ. App., 27 S.W. 1032.

Appellants strongly rely upon the decision in Cleveland v. Ward, supra, as authority for holding that their plea in abatement should have

been sustained. In that case, a suit was filed in the District Court of Johnson County to cancel certain notes and liens. The defendant in the Johnson County case, along with others who claimed to be holders of some of the notes involved, thereafter filed a suit in a District Court of Dallas County to collect the notes and foreclose the liens. A plea in abatement was filed in the Dallas County case setting up the pendency of the suit in Johnson County. Before the plea in abatement was heard, the plaintiffs in the Johnson County case amended and made all the plaintiffs in the Dallas County District Court parties defendant in the Johnson County case. The Johnson County plaintiffs having finally sued all the Dallas County plaintiffs in Johnson County, the Supreme Court held that the Johnson County District Court had jurisdiction of the subject matter and all the parties, and the power and right to proceed to judgment, and the plea in abatement was therefore good. The Supreme Court said, [116 Tex. 1, 285 S.W. 1070], "The district court of Johnson county, then, in permitting the pleadings in that court to be amended so as to bring in parties interested in and to be affected by the decree sought, acted clearly within its express statutory jurisdiction and power to permit additional parties to be made 'when they are necessary or proper parties to the suit.'

"The case therefore stands in that court, in so far as any jurisdictional question is concerned, precisely upon the same basis as if the original pleading filed had embraced fully the declarations of the last amendment, and had made all of those who are now parties to the suit parties in the first instance.

. . . . . .

"The reason of the abatement of the subsequent suit by the first, where the latter is filed in a court of competent jurisdiction, and that jurisdiction has attached, is that, when the suit is brought, it is thereby segregated as it were from the general class to which it belonged, and withdrawn from the authority and jurisdiction of all other courts of co-ordinate power. . . ." The opinion quotes from State ex rel. Sullivan v. Reynolds, 209 Mo. 161, 107 S.W. 487, 15 L.R.A.,N.S., 963, as follows:

" 'It is the possession of jurisdiction of the court over the particular case in litigation that segregates and takes it from the general classes of cases to which it belongs which excludes the jurisdiction of another court of co-ordinate jurisdiction from attaching to the same cause; and the reason for this is apparent, because it no longer belonged to the class of cases over which the latter court has jurisdiction at the time the second suit was filed therein. It had become extinct or ceased to exist as a cause of action so far as the latter court was concerned, and had become merged, as it were, into an action pending in another court.' "

In the case before us, the only defendant in appellants' suit in Harris County was Mrs. Daniels, the payee of the note. The Bank, the holder of the note, had a right to file a suit for its collection, and, not being a party to the Harris County suit, it had a right to choose the forum in which it would litigate. Had appellants amended and made the Bank a party to the Harris County suit, the situation then might have been controlled by the decision in Cleveland v. Ward. We know of no authority for the proposition that the holder of a note, who is not an actual party to a former suit by the maker against the payee to cancel the note, although he could have properly been made a party, cannot maintain against the plaintiff in the former suit a cause in another court for collection of the note. If the Harris County suit had been tried and had resulted in a judgment cancelling the note and liens as against Mrs. Daniels, the Bank could still maintain suit upon the debt and liens to the extent of its interest in the subject matter. Hickman v. Cooper, Texas Civ. App., 210 S.W.2d 858, writ refused, n. r. e.; McKenzie v. Frey, Tex. Civ. App., 198 S.W. 1009.

We are of the opinion that the District Court of Harris County did not have jurisdiction of the Bank's cause of action, the Bank not having been made a party to that suit. Jurisdiction is the power of a court to hear and determine a controversy between parties to a suit. Farmers' Nat. Bank of Stephenville v. Daggett, Tex. Com. App., 2 S.W.2d 834. "There are three elements of jurisdiction: (1) The court must have cognizance of the class of cases to which the one to be adjudicated belongs; (2) The proper parties must be present; (3) the point decided must be in substance and in effect within the issue. . . ." Stewart v. Moore, Tex. Com. App., 291 S.W. 886, 891; see also 21 C.J.S., Courts, §35a, page 43. Jurisdiction of the person of a defendant is acquired by service of such process as the law provides, or by his voluntary appearance, or by his waiver of service. Glass v. Smith, 66 Tex. 548, 2 S.W. 195; 15 C.J., p. 786, sec. 82; Walker v. Koger, Tex. Civ. App., 99 S.W.2d 1034, writ dismissed; Lipscomb v. McCart, Tex. Civ. App., 295 S.W. 245; Swartz v. Caudill, 279 Ky. 206, 130 S.W.2d 80. Appellants' first point is overruled.

Appellants' next contention is that the court erred in overruling their exceptions to appellee's petition because of the failure to allege that it had no other security for its debt from Mrs. Daniels, and that its debt is not collectible otherwise than by this suit. However, appellee's second supplemental petition alleged that it had no other security for Mrs. Daniels' note and she owns no property out of which the debt can be collected and appellee would lose its debt unless allowed to recover in this cause. Although this pleading amounted to an amended rather than a supplemental petition, no complaint was made of the misnomer, and we think the allegation was sufficient, and the court's action in overruling the exceptions was not error.

Appellants' final point is that the court erred in granting judgment for more than the amount of Mrs. Daniels' indebtedness to the Bank. The point is sustained. When there is an issue between the maker and the payee of a note, the holder of the note pledged as collateral security for a debt is protected only to the extent of the indebtedness thereby secured. Blackburn v. Temple Nat. Bank, Tex. Civ. App., 216 S.W.2d 233, writ refused, n. r. e.; Iowa City State Bank v. Friar, Tex. Civ. App., 167 S.W. 261; Live Stock State Bank v. Locke, Tex. Civ. App., 277 S.W. 405, writ refused; City Nat. Bank of Galveston v. Pearce, Tex. Civ. App., 291 S.W. 291; Wright v. Hardie, 88 Tex. 653, 32 S.W. 885; Harrington v. H. B. Claflin & Co., 91 Tex. 294, 42 S.W. 1055; Van Winkle Gin & Machinery Co. v. Citizens' Bank of Buffalo, 89 Tex. 147, 33 S.W. 862; Wharton v. Washington County State Bank, Tex. Civ. App., 153 S.W. 699. In Iowa City State Bank v. Friar, supra, it is said [167 S.W. 263]: "The innocent holder of a negotiable note as collateral security, to which there is a valid defense against the original payee, is protected, but only to the extent of his interest—the amount of the debt for which it is held as collateral." Since the debt owing to appellee Bank by Mrs. Daniels determines the amount of its claim, appellee can recover for interest only as provided for in its note made by Mrs. Daniels, and not as provided for in the note executed by appellants. Blackburn v. Temple Nat. Bank, supra.

In this case, it is immaterial that appellants have not established their right to cancel the note as against Mrs. Daniels. That issue can only be determined by the District Court of Harris County. Although the Bank alleged that no fraud had been practiced upon appellants in the procurement of the note, and that if they ever had the right to rescind, they lost it by continuing to use the property and by renting it to other persons, we do not construe the trial court's judgment as a holding that those issues were resolved against appellants. That cause of action having been "segregated" by the filing of the Harris County suit and "withdrawn from the authority and jurisdiction of all other courts of co-ordinate power," the 133rd District Court of Harris County alone had jurisdiction of that cause. Cleveland v. Ward, supra; Conn v. Campbell, 119 Tex. 82, 24 S.W.2d 813.

A computation will show that the total amount due on Mrs. Daniels' note at the date of the judgment, including principal, interest and attorney's fees, was $17,355.46. The judgment of the trial court is reformed to allow recovery by appellee for its debt in the amount of $17,355.46, with interest from September 26, 1952, at five per cent per annum; in all other respects the judgment is affirmed.

The costs of the appeal are adjudged against appellee.

Bank's Acquiescence Bars Benefits of Bulk Sales Act

A partnership was indebted to a bank on two notes. It sold all its assets to a corporation which was formed and substantially owned by the two individuals who made up the partnership. No notice of the sale was given to the bank as required under the terms of the Bulk Sales Act since the corporation assumed and agreed to pay all debts of the partnership. The bank, however, did know of the transaction and in fact was consulted from time to time about it. Also at the time of the sale the bank received a partial payment on the notes from the corporation. Later, when the corporation went bankrupt, the bank sought to reclaim the assets transferred from the partnership to the corporation on ground that the transfer was void since the bank had not received formal notice as required under the Bulk Sales Act.

The court ruled against the bank stating that even though it was doubtful that the Bulk Sales Act was applicable here, it was clear that the bank could not accept benefits resulting from a transaction at one time and later, when the transaction was ultimately unsuccessful, assert it was void for lack of formal notice. *Hillsboro National Bank v. Buscher,* U. S. Court of Appeals, Seventh Circuit, 204 F.2d 520. The opinion of the court is as follows:

FINNEGAN, C.J.—On June 14, 1950, the Hillsboro National Bank filed its petition for reclamation in the bankruptcy proceedings of The Gill-Owen Company, voluntary bankrupt. Eighteen other persons, firms and corporations likewise filed reclamation petitions in the same matter, some on the same day, June 14, 1950, and others shortly before or after that date.

In the various petitions, the petitioners alleged that they were creditors of a co-partnership doing business as Litchfield Precision Products, the partners being one David E. Owen and one E. A. Gill. The petitioners sought to reclaim all of the stock of merchandise, or merchandise and fixtures or other goods and chattels which they alleged had been sold by Litchfield Precision Products to The Gill-Owen Company, a corporation, on August 31, 1948, otherwise than in the ordinary course of trade. Lists

NOTE—For similar decisions see B. L. J. Digest (Fifth Edition) §1358.

of the goods and chattels sought to be reclaimed were attached to the petitions. The petitions charged that the property sold to the corporate bankrupt on August 31, 1948, embraced substantially all of the assets of the partnership, Litchfield Precision Products. The petition further alleged that the various petitioners, creditors of the partnership, had not been given written notice of the sale as required by the Bulk Sales Act of the State of Illinois, Smith-Hurd, Ill. Ann.Stat.Ch. 121½, § 78 et seq., and that as a consequence said sale of August 31, 1948, was void as against petitioners, and that the assets then sold belonged to the petitioners.

In its brief in this court, appellant states that by agreement of all the parties, the outcome of all other reclamation petitions, except that of D. E. Owen, would abide by the result and decision arrived at on the petition of the Hillsboro National Bank. We therefore limit our consideration to that petition, the answer of the Trustee in Bankruptcy thereto, and the facts disclosed on the hearing thereof.

In answer to appellant's petition the Trustee in Bankruptcy, after a general denial of the allegations in the petition, alleged that the sale and transfer of the goods and chattels from Litchfield Precision Products to the corporate bankrupt, on August 31, 1948, was not such a transfer as required compliance with the Bulk Sales Act of Illinois. The answer further claimed that if said Bulk Sales Act were held to apply to said sale, the petitioner-appellant had waived its right to complain of said sale because: (1) appellant has been guilty of laches; (2) it affirmed said sale by accepting the terms thereof which provided that The Gill-Owen Company assumed and agreed to pay all the debts of Litchfield Precision Products, and that petitioner with full knowledge of the facts has accepted payment from the corporate bankrupt on the indebtedness of said partnership and has thereby ratified and confirmed the sale of August 31, 1948, and (3) that under the facts and circumstances the appellant is estopped from recovering the goods and chattels transferred and that appellant has filed its claim against the corporate bankrupt, participated in the selection of a trustee and has made frequent appearances in the bankruptcy proceeding.

The matter was first heard by the Referee in Bankruptcy who found in favor of the petitioners in reclamation and ordered that the proceeds of the sale (in bankruptcy) of the goods and chattels transferred on August 31, 1948, amounting to $20,546.33, less costs of administration, should be distributed to the petitioners in reclamation in due course of administration. The Trustee in Bankruptcy petitioned for a review of the referee's order and prayed that the entire record be certified to the District Court.

After consideration of the record and of the briefs and arguments submitted by the parties involved, the District Judge held that the

reclamation petitioners were not entitled to the proceeds of the sale of the goods and chattels transferred, but should be treated as general creditors of The Gill-Owen Company. An order to that effect was entered by the District Judge on July 30, 1952. Motions for a new trial and for reconsideration were entered and denied on August 28, 1952. This appeal followed.

A brief statement of the facts disclosed by the record, which are practically undisputed, will aid in the consideration and appraisal of the contentions presented by the appellant and by the appellee.

Early in 1941, David E. Owen, with his wife and one E. A. Gill, formed a partnership, calling it Litchfield Precision Products. In the partnership Owen owned a 40% interest, his wife a 20% interest and Gill a 40% interest. Owen later acquired the interest of his wife. The partnership acquired precision machinery and obtained contracts for war purposes.

In September of 1945, Gill and Owen, along with other small stockholders, incorporated The Gill-Owen Company. This company was organized as a sales agency for the Litchfield Precision Products. On August 31, 1948, the Litchfield Precision Products, the partnership, sold to Gill-Owen Company, the bankrupt herein, 95% of its assets. This was done in order to reduce the office force and overhead expense, and as a part of said transaction Gill-Owen Company assumed and agreed to pay all partnership indebtedness.

Gill and Owen were advised that since they were partners and owned all the interest in the partnership and substantially all the stock in the corporation, and since they expected to pay all the obligations of both, there was no need for them to comply with the Bulk Sales Act in selling and transferring the assets of the partnership to the corporation. Therefore neither the partnership nor the corporation gave any notice to the creditors of the Litchfield Precision Products, the partnership, of the intended sale. No attempt was made by either to comply with the provisions or requirements of the Bulk Sales Law of the State of Illinois.

The record does however show positively that the Hillsboro National Bank did, at or about the time of the transaction, have actual knowledge of the transfer of the goods and chattels involved by the partnership to the corporate bankrupt. The partners advised and consulted with the president of the bank. Both the partnership Litchfield Precision Products and The Gill-Owen Company, Incorporated, maintained checking accounts with the bank. As a matter of fact the record discloses that after the transfer of the partnership assets to the corporation, payroll checks were issued on Litchfield Precision Products check forms and were honored and paid by the bank with funds furnished by The Gill-Owen Company for a payroll account. It was claimed that this was done

because the Litchfield partnership had a large number of such forms, which had been printed on the firm's order, still on hand and it would have been wasteful not to use them. This practice continued until 1949.

Moreover, it appears that the bank was acquainted with every detail regarding the financial standing of the co-partnership and of The Gill-Owen Company. The president of the bank visited the plant of the company, saw and examined the machinery. He inquired and was told the names of the attorneys who were handling the transfer. The bank also transferred the account of Litchfield Precision Products to The Gill-Owen Company.

At the time of the hearing the bank had in its possession and produced two notes signed by the Litchfield Precision Products and the co-partners. One for $14,000 was dated March 27, 1949, and the second for $17,900 was dated June 24, 1949. There were renewal notes evidencing the indebtedness of the partnership to the bank on August 31, 1948.

The bank likewise produced at the hearing two notes of The Gill-Owen Company, one for $14,000 dated August 27, 1949, and the other for $17,900 dated August 24, 1949. The president of the bank testified that these latter notes were never used, never went into the bank. They were taken because Gill-Owen was to obtain new capital but failed. They never paid interest on these notes.

Finally the bank took a note for $16,900, dated November 17, 1949, signed by The Gill-Owen Company and secured by a chattel mortgage and also a note of the company for $30,000 dated November 26, 1949, and secured by a real estate mortgage which is stated to be unrecorded.

The record further discloses that the bank was paid $2600 by The Gill-Owen Company on the partnership indebtedness of August 31, 1948. It likewise appears that The Gill-Owen Company in discharge of its promise to assume the partnership debts had paid to creditors, other than the bank, sums aggregating from $12,000 to $14,000.

The appellant claims that the transfer to the corporate bankrupt by the partnership was void under the Illinois Bulk Sales Act, and that the order appealed from should be reversed and the order of the referee should be reinstated.

Appellee contends that the Illinois Bulk Sales Act was not applicable to the transaction of August 31, 1948. It then urges that even if said act is applicable, the petitioner, under the facts and circumstances shown by this record, is estopped to avoid such transaction and has lost by waiver any right to upset it.

In stating the reasons which impelled him to conclude that the petitioners in reclamation were not entitled to the proceeds of the sale of the goods and chattels transferred by a partnership to The Gill-Owen

Company, but that they should be treated as general creditors of the corporate bankrupt, the trial court said:

> "Under such circumstances I think it extremely doubtful whether the Bulk Sales Act applies; but I shall not labor that question as I am fully convinced that the bank, having acquiesced in the sale and received the benefits therefrom, is not now in a position to prevail in their reclamation petition. The bank accepted the benefits of the transfer knowing all the facts, and later when bankruptcy intervened, filed their claim against the corporation as a general creditor. Now at a later date they are seeking to the exclusion of general creditors to impress a lien on the property transferred to the corporation by the co-partnership on the theory of non-compliance with the Bulk Sales Act. The bank evidenced satisfaction with the transfer although they received no written notice as provided by the Act, cooperated with the transferrer and the transferee in an effort to liquidate their claim and did in fact partially liquidate the same with money which the corporation received and paid them as a direct result of their operations under the transfer. The bank accepted the benefits of the transfer as long as benefits were forthcoming, but now that benefits have ceased and bankruptcy intervened they are asserting that the transfer was at all times void. To permit them to thus gain what advantages could be had by reason of the transfer and then later assert a claim to the property thus transferred because of a failure to give notice under the Bulk Sales Act would permit the Bulk Sales Act to become an instrument of fraud rather than one of protection of creditors. The reclamation petitioner does not come into this, a court of equity, with clean hands."

We agree with the conclusions reached by the trial court and believe it is supported by overwhelming competent authority.

15 A.L.R.2d on page 937 contains an annotation entitled: "Waiver, Estoppel, Acquiescence or Laches of creditor with respect to attack on sale under Bulk Sales Act." On page 939 of said annotation, it is said:

> "It appears to be well settled that creditors may waive the right to the benefit of the Bulk Sales Statutes, or estop themselves to claim that the sale was invalid because the requirements of the Bulk Sales Statute were not fully complied with."

The editors cite decisions from courts of review in sixteen of the States and from the Dominion of Canada in support of this proposition. Two of the cases cited are from the Appellate Court of Illinois: Jeffry Hotel Corp. v. Chicopulos, 262 Ill.App. 537; and Marshall Co. v. Leon, 267 Ill. App. 242.

In the Jeffry Hotel case, which was decided in 1931, it developed

that a garnishee had purchased hotel furniture in violation of the Bulk Sales Act of Illinois. The evidence disclosed that the plaintiff, who was the holder of a chattel mortgage upon the furniture sold, had agreed to a general compromise of the seller's obligations. The court held that the plaintiff was estopped from claiming a violation of the Bulk Sales Act by the garnishee.

In Marshall Co. v. Leon, which was decided in 1932, it held that a creditor who affirmatively consents to the sale by his debtor of a stock of merchandise, is not entitled to claim that the sale was fraudulent and void because there was a failure to give notice as required by the Bulk Sales Act of Illinois. This case was cited with approval in Brady v. Marshall, 302 Ill.App. 151, 23 N.E.2d 764, which was decided in 1939. In the Marshall case the Appellate Court reversed a judgment for a creditor because of the exclusion of evidence. It said on page 158 of 302 Ill.App., on page 767 of 23 N.E.2d:

> ". . . In the absence of this evidence we will not pass on the question of whether it was sufficient to create an estoppel, although it would seem on principle plaintiff would be estopped to complain that notice was not given under the Bulk Sales Act, if he in fact participated in and took the benefits of a transaction with full knowledge that such notice was not given."

The order and judgment of the District Court is affirmed.

Bank Denied Recovery of Interest on Note

In 1929 decedent made a promissory note payable to a bank on demand "with Int." Decedent made the last payment which was applied to the principal of the note in 1945 and from 1940 to 1945 the bank sold certain collateral it held and credited it entirely to principal. The last payment of interest was made in 1940, and consequently, decedent's representative claimed that the bank was prevented by the statute of limitations from collecting the unpaid interest on the note. The court held that under these circumstances, the bank would not be able to collect the interest because of the statute of limitations unless a jury found at a trial of the facts that a promise to pay the whole indebtedness *including interest* could be inferred from the payment on principal made by decedent in 1945. *Arkport*

NOTE—For similar decisions see B. L. J. Digest (Fifth Edition) §1386.

State Bank v. Nutter, Appellate Division, New York Supreme Court, 282 App. Div. 412. The decision of the court is as follows:

PER CURIAM—This action against the executrix of the decedent's estate is for the recovery of a balance of unpaid principal and interest upon a promissory note dated January 3, 1929, for $12,500 payable upon demand "with Int". The amount of principal unpaid on the note is $517. Upon the trial the court directed a verdict for such sum plus accrued interest amounting in all to $7,286.02.

The plaintiff must rely upon a payment on principal of $182.92 made by the decedent on January 26, 1945, to toll the Statute of Limitations. Proceeds from the sale by plaintiff of collateral and credited against the debt does not extend the statute. (See *Brooklyn Bank v. Barnaby,* 197 N. Y. 210.) There have been no payments by the decedent of interest since February 1, 1940, nor has the plaintiff credited any part of the proceeds of the various sales of collateral upon interest. We are not unmindful of the general rule that part payment of principal ordinarily tolls the statute as to both principal and interest unless the debtor expressly disavows the interest. The circumstances here, however, are such that we are unable to say as a matter of law that from such payment the decedent made a new promise to pay the entire debt including interest. In order to toll the statute such further payment must have been made under such circumstances as would warrant a jury in finding an implied promise to pay the entire debt (*Crow v. Gleason,* 141 N. Y. 489, 493; *Matter of Fitch,* 270 App. Div. 227).

During the period from February 1, 1940, when decedent made the last payment on interest, until January 26, 1945, when he made the above-mentioned part payment of principal, the decedent made fourteen payments on principal but none on interest. During the same period the plaintiff credited the proceeds from five sales of collateral entirely on principal. Subsequent to that time the plaintiff credited the entire proceeds of two further sales of collateral on principal all notwithstanding the general rule that payment upon a debt consisting of principal and interest is first applied to interest and then to principal (see *Shepard v. City of New York,* 216 N. Y. 251). The bank's ledger sheets which were introduced in evidence carry no charge against the decedent for interest but only for principal. The widow of the decedent testified that when she asked the cashier and director of the bank for the amount of her husband's indebtedness after a claim executed by him had been filed in Surrogate's Court, that he told her "It wouldn't exceed over a thousand dollars". The mere fact that part payment was made by the decedent during his lifetime and within the statutory period is not enough. The

burden was upon the plaintiff to show that it was made under circumstances from which a promise may be inferred to pay the entire debt including interest (*Crow v. Gleason*, 141 N. Y. 489, 493, *supra*).

We are of the opinion that it was error to direct a verdict for the plaintiff. We think that upon this record the question of whether the payment of $182.92 on January 26, 1945, was made under circumstances from which a promise to pay the entire indebtedness including interest may be implied, presented a question of fact for the jury.

The judgment appealed from should, therefore, be reversed and a new trial ordered, with costs to the appellant to abide the event.

All concur, except TAYLOR, P. J., who dissents and votes for affirmance. Present—TAYLOR, P. J., MCCURN, KIMBALL and PIPER, JJ.

Judgment reversed on the law and facts and a new trial granted, with costs to the appellant to abide the event.

Franchise and Excise Taxes on Trust Companies Measured in Part by Federal Obligations Held Valid

Two Tennessee companies, one a trust company, have brought suit against the State Commissioner of Finance and Taxation claiming that certain franchise and excise taxes levied on the companies violate the Federal Constitution and a Federal statute because United States Government bonds and income on such bonds were included as a measure of the taxes. The court ruled against the companies. It reasoned that the taxes were levied on corporations for the privilege of doing business in Tennessee and as such did not constitute a state tax on United States obligations. *Nashville Trust Co. v. Evans, Guaranty Title Company v. Evans,* Supreme Court of Tennessee, 258 S.W.2d 761. The opinion of the court is as follows:

BURNETT, J.—The two above styled suits involve the same questions of law and even though they are separate suits they were treated by counsel and the Chancellor below in one opinion as they involve the identical question. It was agreed in the oral argument that one opinion might be filed by this Court applicable to both suits.

NOTE—For similar decisions see B. L. J. Digest (Fifth Edition) §1500.

The suits were filed to recover certain franchise taxes and excise taxes which the two complainants had previously paid under protest to the Commissioner of Finance and Taxation. A demurrer to these suits was filed by the Commissioner to each suit predicated upon the ground that neither the franchise tax nor the excise tax was a tax upon the obligations of the United States or the income therefrom, but on the contrary the franchise tax and the excise tax were both non-discriminatory privilege taxes, levied upon all corporations for profit and doing business in Tennessee, that such taxes are imposed for the privilege in engaging in business in corporate form and are in no sense a direct tax upon the obligations of the United States or the income therefrom. The Chancellor in an excellent opinion sustained the demurrers. An appeal has been duly perfected, the cases have been ably briefed and argued before this Court. We now have the matter for determination.

It is insisted by the complainants that the State through its Commissioner of Finance and Taxation included obligations of the United States Government and income therefrom as a measure of the franchise tax and excise tax, respectively, in its tax and by so doing contravened Article I, Section 8 of the Constitution of the United States, which authorizes the United States to borrow money on its credit; and that it likewise was in conflict with Section 3701 of the Revised Statutes, 31 U.S.C.A. § 742, which provides as follows:

> "Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority."

In the brief and argument of the appellant it is said:

> "It is realized that the learned Chancellor decided the cases in question in accord with the previous decisions of this court. The suits would not have been instituted except for a recent decision of the Supreme Court of the United States. The questions involved have been settled by the Supreme Court of Tennessee in the case of National Life & Accident Insurance Company v. Dempster, 168 Tenn. 446 [79 S.W.2d 564]; Reynolds Tobacco Company v. Carson, 187 Tenn. [157] 162 [213 S.W.2d 45]; and American Bemberg Corp. v. Carson, 188 Tenn. [263] 272 [219 S.W.2d 69]."

In Reynolds Tobacco Co. v. Carson, 187 Tenn. 157, 213 S.W.2d 45, 47, this Court defined the nature of franchise and excise taxes as follows:

> "The excise tax and the franchise tax are both privilege taxes (Corn v. Fort, 170 Tenn. 377, 95 S.W.2d 620, 106 A.L.R. 647) levied on corporations for the privilege of doing business in Tennessee. The excise tax is measured by the 'net earnings' (Bank of Commerce & Trust Co. v. Senter, 149 Tenn. 569, 596, 260 S.W. 144) within the State, and the franchise tax undertakes to reach the use of the cor-

porate franchise and is based on that proportionate part of the corporate capital stock, surplus and undivided profits employed in doing the business in Tennessee. . . ."

The contention of the appellants is that it matters not whether the tax is described as a franchise or excise tax, but that it is a question of whether or not the tax is imposed on Government obligations and the income therefrom. And it is thus argued that when Tennessee imposes a franchise and excise tax on income from non-taxable Government Bonds that then this tax is unconstitutional as violating Article I, Section 8 of the United States Constitution heretofore referred to and is likewise violative of Section 3701 of the Revised Statutes, 31 U.S.C.A. § 742, heretofore referred to. In support of this contention and argument the appellants contend that the Supreme Court of the United States in New Jersey Realty Title Insurance Company v. Division of Tax Appeal, 338 U.S. 665, 70 S.Ct. 413, 94 L.Ed. 439, held that the tax was uncollectible because it did impose an obligation on these non-taxable Government Bonds. It is likewise said that the Supreme Court of Ohio in Wren Paper Company v. Glander, 156 Ohio St. 583, 103 N.E.2d 756, held likewise and relied upon the New Jersey case last above cited. Much argument is made, the basis of which is certain language that we used in the case of Madison Suburban Utility District of Davidson County v. Carson, 191 Tenn. 300, 232 S.W.2d 277, to the effect that the Court has decided to apply certain language of the New Jersey case to situations as exist in the present case. In the Madison Suburban Utility District v. Carson case we used this case and quotations made from the New Jersey case in the argument in support of our opinion in that case. The question though involved in the Madison Suburban Utility District v. Carson case was an entirely different question from that involved in the instant cases. In the Madison Suburban Utility District v. Carson case we were dealing with sales and use tax liability of the district and in so doing we cited the New Jersey Realty Title Co. case solely upon the point that courts will look through the form and to the substance of a taxing statute.

The New Jersey case, it seems to us, was a tax on net worth and was not considered as imposing a tax upon the privilege of franchise "by either the New Jersey Legislature or the taxing officials or by any of the courts below . . . " [338 U.S. 665 70 S.C. 418.]. This being true it seems to us that the case is not in point and is not authority in the instant cases. It is true there is a limited amount of dictum in the New Jerey case which would seem to support the contention of the appellants herein. We, though, feel that we should not be required to follow this dictum. In view of the fact that the Supreme Court of the United States did not expressly overrule previous decisions of that court such as Educational Films Corp. of America v. Ward, 282 U.S. 379, 51 S.Ct. 170, 75

L.Ed. 400, and Tradesmens National Bank of Oklahoma City v. Oklahoma Tax Commission, 309 U.S. 560, 60 S.Ct. 688, 84 L.Ed. 947, and others, which support the holdings of this Court in the Dempster case supra, we will not overrule the holding of this Court in National Life & Accident Insurance Company v. Dempster, supra, and other cases of like import.

It results that the judgment of the Chancellor must be affirmed.

Guarantor Liable to Bank for Corporation's Unpaid Accounts Receivable

Certain guarantors agreed to guarantee a corporation's debts, including "debts, obligations and liabilities . . . however arising, whether due or not due, absolute or contingent. . . ." A bank agreed to buy the corporation's accounts receivable and the latter consented that if it should become bankrupt, it would pay the bank on demand the aggregate amount of any unpaid accounts. When the corporation did, in fact, become bankrupt, the guarantors refused payment to the bank on ground that the bank had not really become a creditor of the corporation by purchasing the accounts receivable but was rather only a creditor of the corporation's customers. The court held in favor of the bank. The contingent liability of the corporation became absolute at the time of bankruptcy and as such became an obligation covered by the guarantee. *Bank of America National Trust and Savings Association v. Burhans et al,* Supreme Court of Wisconsin, 60 N.W.2d 725. The opinion of the court is as follows:

BROWN, J.—Respondents submit that the purchase of accounts receivable by the bank as alleged in the complaint did not make the National Cart Corporation debtor to the bank; also that National Cart Corporation's agreement with the bank was a guaranty of the debts of its customers and they contend that appellant is trying now to convert respondents' guaranty of National Cart Corporation's debts into a guaranty of the Corporation's guaranty.

In view of the broad language of the guaranty defining the term "indebtedness," the respondents' argument cannot succeed. "Debts, obligations and liabilities" of the National Cart Corporation, "voluntary or

involuntary," "absolute or contingent," are included in respondents' promise to pay.

In referring to the agreement between National Cart Corporation and the appellant bank, the complaint alleges:

"That under the terms of said agreement it expressly provided that in the event said National Cart Corporation shall be adjudicated a bankrupt, said National Cart Corporation will, on demand, pay plaintiff the aggregate principal amount then owing on all unpaid accounts then outstanding."

Here, certainly, is a contingent liability which, as the complaint alleges in the next paragraph, became an absolute one by the adjudication of bankruptcy. When that obligation became fixed by the occurrence of the event provided for, the outstanding accounts became the obligations of the National Cart Corporation due to the latter's unequivocal promise to pay them. They were no longer only the debts of the National Cart Corporation's debtors but were the corporation's own debts. The contingency having occurred, the situation is the same as the one treated in Drovers' Deposit Nat. Bank v. Tichenor, 1914, 156 Wis. 251, 145 N.W. 777, 778. When Tichenor discounted the notes of Nicholson at the Drovers' Bank he signed an instrument which called itself a guaranty and which recited " 'We do hereby promise and agree to pay said notes at maturity, . . .' " Nicholson did not pay one of the notes and the bank sued Tichenor on it. He demurred to the complaint and submitted that his was an agreement to pay the debt of another and certain requirements of the statute of frauds applicable to agreements to pay the debts of another were lacking. We held that the statute did not apply, even though the instrument was referred to as a guaranty. Tichenor had not agreed to pay the debt of another if that person did not pay but had agreed to pay absolutely, thus making the note his own debt. So here, National Cart Corporation promised to pay the accounts, —not if the original debtors failed to pay—but if the National Cart Corporation was adjudicated bankrupt. The event occurred, the obligation matured and the indebtedness, liability or obligation became that of the promisor.

The case of Sharpe v. First Nat. Bank of Antigo, 1936, 220 Wis. 506, 264 N.W. 245, 246, cited by respondents, is easily distinguished. There Johns agreed to pay to the bank " 'all loans . . . accounts . . . liabilities . . . now owing, or which may hereafter become due or owing by the Antigo Canning Company, . . .' " to the bank.

Next, Johns borrowed $6,750 from the bank and simultaneously plaintiff executed this: " '. . . (I) do hereby agree to pay . . . to The First National Bank . . . all loans, . . . notes, . . . liabilities of every kind and description now owing, or which may hereafter become due or owing

by R. B. Johns . . . to said Bank.'" Plaintiff did pay this note to the bank but in so doing he borrowed $6,000 from the bank upon his own collateral note. The collateral agreement stated that the collateral was pledged not only for the payment of the $6,000 note but "'. . . for the further security and payment of any and all indebtedness which the undersigned (plaintiff) may now or hereafter be owing to the said . . . Bank. . . .'" About three years later the bank told plaintiff he had guaranteed the obligations of the canning company. Plaintiff offered to pay his note and take back the collateral. The bank refused to accept payment or release the collateral. Later the collateral was released but its value had gone down and plaintiff sues for such difference in value. The case turns on whether plaintiff had become a guarantor of the debts of the canning company. This was not an action by the bank against Johns for his agreement to pay the liabilities of the canning company. Neither was it an effort to enforce any payment by the plaintiff on account of the debts of Antigo Canning Company. It does not appear that there were any such debts. The case does not say that Sharpe is *not* liable as Johns' guarantor if Johns, as a guarantor of the canning company, should become liable. The opinion is restricted to Sharpe's liability under his collateral note which pledged the security for his own "indebtedness." The court said that the term "indebtedness" was the equivalent of "debt" and a contingent liability is not a debt. The case recognizes, 220 Wis. at page 510, 264 N.W. 245, that at some time a claim might be made against Sharpe for the canning company's liabilities because of the guaranty he had given in the Johns matter; but it held that when Sharpe tendered payment of his note he was entitled to receive his collateral and under the terms of his agreement the bank could not hold the security for Sharpe's "debt" to be security for a contingent liability which had not become a debt when payment was offered. In the instant case, respondents did not limit their undertaking to the National Cart Corporation's debts as the term is used in the Sharpe case, supra. They expressly included a promise to pay the contingent liabilities of National Cart Corporation. The contingent liabilities have become absolute and respondents' obligation has matured and is enforceable.

Respondents also rely on National Bank of Commerce of Kansas City, Mo. v. Rockefeller, 8 Cir., 1909, 174 F. 22. The facts in that case also were very different from the ones now before us. The bank was not suing Rockefeller on his guaranty. On the contrary, Rockefeller had paid his guaranty and brought the action to force the bank to release to him certain collateral posted by the primary debtor to secure the primary debt. The trial court decreed the release but on appeal this part of the judgment was reversed because the collateral also secured debts incurred before Rockefeller executed his guaranty and not guaranteed by him. It was held that the bank was entitled to keep the collateral

until such debts were paid. Respondents refer us to that part of the opinion which states that a guaranty of debts does not render the signer liable on the debtor's guaranty of collateral notes. We quote from respondents' brief: ". . . The Court said that the guaranty did not constitute debts of the corporation but were merely executory contracts on which its liability was contingent and as such were beyond the scope of the guaranty. . . ."

We think the federal court was right. Rockefeller's guaranty was for nothing but the debts of the company. The collateral notes were not in default, and had not become the debts of the company. The company's liability at the time of the suit was contingent only and of course was not included in a guaranty confined to company debts. But in our own case not only had the contingency occurred which matured the National Cart Corporation's obligation and transformed what had been the debt of another into its own debt, but the respondents had expressly guaranteed the contingent obligations and liabilities of the National Cart Corporation. The reasoning and result in the Rockefeller case, supra, does not conflict with a decision that the guaranty of respondents is broad enough to cover the debts assumed by the National Cart Corporation as such matters are pleaded. We conclude that the complaint states facts sufficient to constitute a cause of action.

Order reversed and cause remanded for further proceedings not conflicting with the opinion.

Bank's Mortgage Held Prior to Maritime Lien

The Flying Cloud, a fishing vessel, was subject to two preferred ship mortgages on it which were held by a bank. After a year of operation repair work was done on the "Cloud" creating what is known as a maritime lien. When the boat owners defaulted on the mortgage payments the bank foreclosed and the vessel was sold. The repairmen claimed priority on their liens on ground that a clause in the mortgage permitting the mortgagor to incur expenses for repairs was the bank's acknowledgement that maritime liens were to be prior to the mortgage. The court held in favor of the bank. It determined there was no reason why a preferred mortgage and a lien for repairs could not exist at the same time. The mortgage clause merely permitted maritime liens but this did not constitute a

waiver by the bank of its preferred status. Also the court noted that there was no obligation on the mortgagee bank specifically to prohibit such liens by terms of the mortgage. *Crofton Diesel Engine Co., Inc. et al v. Puget Sound National Bank of Tacoma et al,* U. S. Court of Appeals, 9th Circuit, 205 F.2d 950. The opinion of the court is as follows:

POPE, C. J.—This is an appeal from a final decree in admiralty which determined the relative priorities of certain valid maritime liens on the one hand and two mortgages on the other. The mortgages and liens were upon a fishing vessel, The Flying Cloud. Decree was in favor of the appellee Puget Sound National Bank of Tacoma, hereafter called the Bank, and against the appellants, herein called Crofton and Larson, holders of the maritime liens who, after the Bank had filed a libel for foreclosure of its two mortgages, filed libels in intervention.

The Bank took from the owners of The Flying Cloud as security for a note, a mortgage on the vessel which was entitled "Preferred Mortgage of Vessel." A ship building corporation took a similar mortgage to secure a note representing a part of the purchase price of the vessel. The latter mortgage was duly assigned to the Bank. Both mortgages were recorded and endorsed upon the vessel's documents, in accordance with the provisions of § 922 of Title 46 U.S.C.A.

About a year later, at San Pedro, California, the owners had some work done on the vessel by Larson and approximately six months thereafter Crofton did some engine work and furnished some supplies for it. To secure his claim Crofton took a mortgage which was designated "Third Preferred Mortgage." Later Larson did further work on the vessel for which he also claims a lien.

The owners having defaulted upon the Bank's notes, the latter filed suit to foreclose the mortgages. The vessel was sold and the proceeds deposited in the registry of the court. As the proceeds were insufficient to pay all mortgages and liens, a determination of their relative priorities was necessary.

Appellants challenge the standing of the Bank's two mortgages as preferred mortgages entitled to priority under the district court's decree on the ground that in each mortgage there appears the following provision: "But if default be made in such payments, or in any one of such payments, or if default be made in the prompt and faithful performance of any of the covenants herein contained, or if the said party of the second part shall at any time deem itself in danger of losing its debt . . . or if said first parties shall suffer and permit said vessel to be run in debt to an amount exceeding in the aggregate the sum of a *reasonable sum for strictly current operation and repairs to be kept cur-*

rently paid within 30 days of the date incurred . . . the second party is hereby authorized to take possession of said goods" etc. (The portion in italics indicates typewritten matter inserted in the printed form.)

The trial court found that both of the Bank's mortgages were executed, recorded and endorsed upon the documents of the vessel in compliance with law; that in each case the affidavit of good faith was filed with the record of the mortgage, and that each mortgage was made in good faith; that neither mortgage stipulated that it waived the preferred status thereof, and that one of the Bank's mortgages was a valid first preferred ship's mortgage and a first lien on the proceeds of sale of the vessel, and that the other was a valid second preferred ship's mortgage, and was a valid second lien on the proceeds of the vessel; that both such mortgages were entitled to priority ahead of the claims of the appellants.

Appellants say that the district court was in error because it failed properly to interpret and give effect to the clause in the mortgages which is quoted above. They contend first, that the quoted language constitutes a stipulation that the mortgagee waived the preferred status of the mortgage; and second, that the only reasonable interpretation of this provision is that the mortgagor in possession is thereby expressly authorized to incur liens, and unless the mortgagor was specifically prohibited by the mortgage from incurring liens, the appellant's maritime liens must prevail.

What constitutes a preferred mortgage upon a vessel is stated in § 922 of Title 46 U.S.C.A. It provides in general that the mortgage must be endorsed upon the vessel's documents in the manner provided in the section; that it must be recorded; that there must be an affidavit of good faith; and that the mortgagee be a citizen of the United States as defined by law. No question is raised but that the mortgages here satisfy those requirements. Subdivision 4 of the same section further states that the mortgage must satisfy the condition that "The mortgage does not stipulate that the mortgagee waives the preferred status thereof." § 953 recites that the lien of a preferred mortgage "shall have priority over all claims against the vessel" (with certain exceptions not applicable here).

The trial court was of the opinion that notwithstanding the mortgages contained the provision quoted above, and upon which appellants hang this appeal, the mortgages "did not stipulate that the mortgagee waived the preferred status thereof." In this we think that the district court was right. The quoted clause is clearly a condition subsequent which recites certain conditions which will permit the immediate enforcement and foreclosure of the mortgage. As pointed out in The Bergen, 9 Cir., 64 F.2d 877, 879, even where a preferred mortgage con-

tains an express provision that the mortgagor shall have no right or power to impose upon the vessel any lien, the most that the provision contained in the mortgage could do was "to postpone the lien . . . to that of the holder of the preferred mortgage." In short, there is nothing incompatible about the simultaneous existence of a fully preferred mortgage and a lien for repairs and supplies. What the clause here in question did was simply to provide that if debt be incurred for the purposes mentioned, the obligation must be paid within thirty days; otherwise the mortgagee may forthwith move to foreclose. There is no reason here for holding that such language constituted a waiver within the meaning of § 922.

Appellants suggest that the Bank used antiquated forms, designed for use for vessels under 200 tons in the years before 1935 when the Act relating to preferred mortgages was amended to include such smaller vessels, (see historical note appended to 46 U.S.C.A. § 922), and that the quoted clause was used to give a measure of protection in these cases where preferred mortgages were impossible. They point to the Crofton mortgage as containing what "any well drawn preferred ship's mortgage" would have,—an express prohibition of liens. However praiseworthy that form is, it has not been prescribed by Congress. If, as appellants allege, the clause here in dispute was "at least ambiguous language" giving a "tacit permission" to impose a lien, the ambiguity, and the permission surely does not go to the extent of stating that such liens are to be prior to the mortgages.

This brings us to the second contention made, namely, that it was encumbent upon the Bank to insert in its mortgages an express and specific prohibition against the mortgagor incurring liens. Appellants arrive at this conclusion by arguing that the mortgagor is in the same situation as a charterer, and they call attention to the charter party cases which hold that as between the charterer and the owner the charterer may create a valid lien, good against the vessel, unless the charter party contains an express prohibition against the charterer creating any such lien. Plenty of cases so hold. Dampskibsselskabet v. Ohio Oil Co., (cited as The Stjerneborg), 310 U.S. 268, 60 S.Ct. 937., 84 L.Ed. 1197; The South Coast, 251 U.S. 519, 40 S.Ct. 233, 64 L.Ed. 386; United States v. Carver, 260 U.S. 482, 43 S.Ct. 181, 67 L.Ed. 361.

We think that the appellant cannot make those decisions carry so much weight here. What is said in those cases arises out of the necessity of an interpretation of §§ 972 and 973 of Title 46. § 972 lists the persons who are presumed to have authority to procure repairs, supplies, etc. § 973 enlarges this by stating that such persons "shall be taken to include such officers and agents when appointed by a charterer . . . but nothing in this chapter shall be construed to confer a lien when the furnisher knew, or . . . could have ascertained, that because of the terms of a

charter party . . . the person ordering the repairs, supplies, or other necessaries was without authority to bind the vessel therefor." The cases thus relied upon by the appellant are no more than a construction and application of the language of these sections, and we see no reason for adding the requirements of a charter party prohibition stated in those cases to the statutory requirements of a preferred mortgage. What makes a preferred mortgage is a compliance with § 922 of Title 46. That compliance existed here. § 953 recites that "the preferred mortgage lien shall have priority over all claims against the vessel" except for certain types of liens not involved here.[1]

We are therefore of the opinion that the decision of the district court upholding the priority of the Bank's mortgages was right. Accordingly, the judgment is affirmed.

[1] There is language in Morse Dry Dock & Repair Co. v. Northern Star, infra, which considered apart from the actual decision in that case, might lend some comfort to appellants. In speaking of a covenant in a ship's mortgage "not to suffer or permit to be continued any lien that might have priority over the mortgage," the court said: "The most that such a contract can do is to postpone the claim of a party chargeable with notice of it to that of the mortgagee," and "So the question more precisely stated is whether the above-mentioned covenants postponed the lien to the mortgage security, as they would seem to do on the facts of the case but for the language of the statute that we shall quote."

Bank Not Liable for Its Vice President's Illegal and Unauthorized Act

The senior vice president of a Texas bank made an oral agreement with plaintiff that the latter's account would be charged various amounts by the bank and the proceeds loaned to one of the bank's customers who needed more credit than the bank itself could extend under the National Banking Act. The bank officer stated the bank would be fully responsible for the amounts charged and would pay an 8% return for the money borrowed. This was later confirmed by letter to plaintiff. When the bank officer died plaintiff tried to collect amounts he claimed had been charged to his account but not repaid. He claimed also that the bank was liable as guarantor on notes which had been made by the bank's customer and guaranteed by the bank.

The court ruled in favor of the bank on ground that the bank officer had not been empowered by the directors to enter

into such an agreement with plaintiff and that even though the directors could have empowered him to borrow money for the bank they could not have authorized him to borrow money in violation of the National Banking laws. *Grammer v. City National Bank of Cleburne,* Court of Civil Appeals of Texas, 262 S.W.2d 106. The opinion of the court is as follows:

HALE, J.—Walter Grammer filed this suit in the court below on July 2, 1951 against the City National Bank of Cleburne, hereafter referred to as the Bank, seeking recovery of $38,532.05 with interest thereon at the rate of 8% per annum from certain dates in 1946. As grounds of the recovery sought, he alleged in substance, among other things, that he was engaged in the business of buying cotton at Cleburne for many years prior to April 1, 1946 and in the conduct of his business he carried a checking account with the Bank under the name of "Walter Grammer Cotton Account"; that W. E. Abbas was the senior Vice-President of the Bank and, on or about April 1, 1946, the said Abbas represented to plaintiff that the Bank had a customer with some R.E.A. contracts who had credit requirements in excess of the amount of money which the Bank could legally loan this customer and that it was the Bank's desire to take care of this customer's credit requirements by charging the plaintiff's cotton account from time to time with such amounts of money as was necessary to carry this excess line of credit for that customer; that Abbas verbally represented to plaintiff that any amounts so charged would be a direct loan by plaintiff to the Bank and the Bank would be fully responsible and liable for said loan and for such charges as might be made to the plaintiff's account, and would repay them at any time plaintiff wanted the money, with interest from the date of any charge so made at the rate of 8% per annum; that the Bank thereafter made seven charges to plaintiff's cotton account, pursuant to said agreement, at different dates during 1946 and on January 4, 1950, in the total aggregate sum of $53,032.67; that the Bank received the benefits of all of the foregoing charges and repaid on its obligation to plaintiff the total aggregate sum of $22,500; that on February 28, 1948, the Bank acknowledged its debt to plaintiff, in writing, and therein agreed and promised to pay plaintiff the sum of $30,532.05 due at that time, with 8% interest thereon.

By his Third Amended Petition which was filed on October 11, 1952, plaintiff impleaded Lyman Walker as a party defendant and, after repleading the substance of the facts alleged in his original petition, he further alleged in the alternative that Walker had executed and delivered to the Bank a promissory note for $23,447.74 and another note for $15,000, which notes were subsequently transferred to plaintiff, with payment thereof being guaranteed by the Bank, that said notes had not been paid

and that he was entitled to judgment jointly, and severally, against Lyman Walker and the Bank as guarantor for the amount of said notes.

For its affirmative defenses, the Bank interposed pleas of limitation of one, two and four years, based respectively on Arts. 342-711, 5526 and 5527 of Vernon's Texas Civ. Stats. The Bank further alleged that the agreement between Abbas and the plaintiff was illegal and could not be enforced; that such agreement was ultra vires and that Abbas had no authority to make it; that the plaintiff was estopped from asserting such agreement as a result of the letter of February 28, 1948 from Abbas to him; that the purported oral guarantee which Abbas was alleged to have made for the Bank was within the statute of frauds; that the notes sued on were never owned, negotiated or guaranteed by the Bank, and Abbas was not authorized to guarantee their payment, and any such act on his part would be ultra vires; and that Abbas was acting as agent for the plaintiff in the transaction and not for the Bank, and any trust violated was the plaintiff's trust, of which the Bank knew nothing and for which the Bank could not be responsible. Although Lyman Walker was duly cited, he failed to appear either in person or by attorney.

The case was tried before a jury. Upon the conclusion of the evidence, the Bank duly presented its motion for a peremptory instruction based primarily upon the affirmative defenses set forth in its answer. The motion was overruled and the case was submitted to the jury on certain special issues, but the jury was unable to agree upon an answer to any of the issues so submitted and was by the court discharged. Thereupon, the Bank presented its motion for judgment in its behalf, notwithstanding the fact that that jury had been unable to reach a verdict, such motion being substantially the same as its original motion for a peremptory instruction. The court granted the Bank's motion and rendered judgment in favor of Grammer against Lyman Walker for the full amount of the notes sued upon, with interest and attorneys' fees, but denied any recovery to Grammer as against the Bank. Hence this appeal.

Appellant predicates his appeal upon two points of error, as follows: (1) "The trial court erred in sustaining the defendant Bank's motion for judgment"; and (2) "The trial court erred in entering judgment that the plaintiff take nothing by his suit against the defendant Bank, because the pleadings and evidence showed the Bank received and retained benefits from the seven charges made to plaintiff's cotton account by Abbas, and it is therefore bound by the representations and agreements Abbas made as its sole representative in the transaction sued on by the plaintiff." On the other hand, the Bank says the trial court did not err in sustaining its motion for judgment for the reasons and upon the grounds set forth in its pleadings.

In passing upon whether the trial court erred in sustaining the motion of the Bank for judgment, this court must view the evidence as a whole

and all reasonable inferences and deductions that may properly be drawn therefrom in the light most favorable to the contentions of appellant. White v. White, 141 Tex. 328, 172 S.W.2d 295; Fitzgerald v. Hull, Tex. Sup., 237 S.W.2d 256, Pt. 1. If the evidence as thus viewed was such as to raise controlling issues of fact which, had such issues been found favorable to appellant, would have entitled him as a matter of law to a recovery against the Bank, then in that event the judgment should be reversed and the cause remanded for another trial in order that the jury might determine such disputed fact issues. On the other hand, however, if the undisputed evidence in the case was such as to prevent appellant from any right of recovery against the Bank, the judgment appealed from should be affirmed even though some of the issues of fact raised by the pleadings of the parties might have been tendered by the evidence because, in that event, the issuable facts in the case would become immaterial to a correct disposition of the cause.

Appellant testified that he lived in Cleburne from 1930 until sometime in 1945, when he moved to Ft. Worth; that he was engaged during that period of time and up to the time of the trial in the cotton business; that in connection with the conduct of his business he carried a checking account with the Bank and borrowed large sums of money of the Bank from time to time; that the Bank had loaned him as much as $350,000 at one time in the operation of his business, and had loaned him as much as $20,000 without any security for the loan; that the Bank charged him interest on his loans for a number of years at the rate of 5% per annum, but as his account became more active the rate of interest had been reduced and for the past six or seven years he had been paying only 4%; that he transacted all of his business with the Bank through W. E. Abbas, with whom he was intimately acquainted. He further testified that Abbas came to his office in Cleburne on the night of April 1, 1946, by previous appointment, and in narrating the conversation which occurred at that time he said: "Well, Mr. Abbas told me that the Bank had a client who needed more money than they were able to lend him, and that he would like for the Bank to charge my account with money over a period of time so that they could take care of this client's loans, and it would run somewhere from twenty-five to thirty thousand dollars. In the conversation he talked about how good the Bank had been to me in the past, and I told him, naturally, that I wasn't in the loan business but if it would be a help to the Bank that I would agree to it provided the Bank was responsible for it and would guarantee it, which he said they would. Q. Did he give you any idea about who that person was? A. He said it was a client who had REA contracts, and the money for that work, construction work, was slow, the government was slow in paying for it, and that is the reason for him needing more money than they could charge his line for. He didn't tell me his name. Q. He didn't

tell you his name? A. No, sir. Q. Was there anything said about whether any interest would be paid? A. He said they would pay me 8% interest, yes, sir."

Thereafter, seven charges were made against the Grammer cotton account on dates and for amounts as follows: April 3, 1946, $7,032.67; April 20, 1946, $12,000; May 28, 1946, $6,500; June 6, 1946, $9,000; June 22, 1946, $5,500; October 19, 1946, $5,000; and January 4, 1950, $8,000. The first withdrawal of $7,032.67 made on April 3, 1946 was evidenced by a debit ticket for that amount against the Grammer cotton account which bore the notation: "Purchase of note. This charge made at the request of Walter Grammer on April 2, 1946." Following this typewritten information was the notation: "O K, W. E. A." in the handwriting of W. E. Abbas. With slight immaterial variations, each of the other six charges against the Grammer cotton account was evidenced by debit tickets bearing substantially the same legend as the first debit ticket which was dated April 3, 1946. Appellant testified that he received each of these debit tickets along with his cancelled checks at the end of each month during which they were charged to his account. He further testified that he was sure he read these debit slips at the time he received them but that he did not pay any particular attention to them or to the manner in which they were written and that he never did at any time during Abbas' lifetime advise the Bank, in writing, that these withdrawals were unauthorized and that he never made any claim that such withdrawals were unauthorized until he filed this suit, and that he never mentioned his alleged agreement with Abbas about guaranteeing the repayment of withdrawals from his account to any officer or director of the Bank until after Abbas had died.

Offsetting, in part, the seven charges which were made against the Grammer account on the dates and for the amounts set forth in the preceding paragraph hereof were three credit items of replacement to the account on dates and for amounts as follows: June 27, 1946, $5,500; July 23, 1946, $9,000; and December 30, 1949, $8,000. The difference between the seven debits and the three credits to which we have referred amounts to $30,532.67. Appellant testified that on February 28, 1948, he told Abbas he thought he should have something in writing to evidence the Bank's liability to him for the charges that had been made against his account and thereupon Abbas, as Vice-President of the Bank, signed and delivered to him a letter reading as follows: "This letter is to confirm that you are carrying for us $30,532.05 in notes on the Lyman Walker Electric Co. account. This being carried for us to avoid an excess line at this bank. This lien is to pay you 8 per cent from date of notes. These notes being secured by assignment of contracts." Abbas died on or about April 30, 1951 under circumstances which indicated that he had committed suicide. After the death of Abbas two notes

were found in his private lock box, each being signed by Lyman Walker, one being dated March 10, 1948, in the principal sum of $23,447.74 and the other being dated March 12, 1951 in the principal sum of $15,000. Each of these notes was endorsed on the back thereof in typewriting as follows: "The within note is hereby transferred to Walter Grammer by W. E. Abbas and payment Guaranteed," such endorsement being signed: "W. E. Abbas." Both notes were in an envelope which bore the notation: "These notes are owned by Mr. Walter Grammer." The records of the Bank show that neither of these notes was ever owned by the Bank and that neither had ever been carried on the books of the Bank as any part of its assets. Walker testified by deposition that he received through Abbas the money for which these notes were given and admitted that he was liable to the owner for the amount due thereon.

The undisputed evidence in the case shows that the Board of Directors of the Bank did not authorize Abbas to borrow money for the Bank in order to loan the same to any of its customers and the Board had no knowledge or notice until after the death of Abbas that the latter had borrowed or attempted to borrow any money for the Bank from Grammer, if he did so. The evidence shows that the Bank had approximately 5 million dollars on deposit which was available to it for the purpose of making lawful loans to its customers at all times material to this suit. Under the Bank's capital structure and the provisions of the national banking laws, 12 U.S.C.A., §§ 24 and 84, the maximum amount which the Bank could legally loan to Lyman Walker was $25,000. The evidence shows that Walker was indebted to the Bank in a sum in excess of that amount at all times material to this suit and that the Bank held Walker's notes for $36,000 at the time Abbas died.

Any attempt on our part to set forth even the substance of all the evidence adduced on the trial of this case would necessarily require this opinion to be extended far beyond the length of propriety. However, after duly considering the evidence as a whole in the light most favorable to the contentions of appellant, we have concluded that the trial court did not err in sustaining the Bank's motion for judgment or in entering judgment that appellant take nothing by his suit against the Bank.

Since Abbas had no authority, either express or implied, from the Board of Directors of the Bank to enter into the agreement to which appellant testified, we do not think the Bank is legally bound by such agreement or that, under the circumstances shown by the undisputed evidence before us, it is in any wise liable to appellant by reason thereof. Western National Bank v. Armstrong, 152 U.S. 346, 352, 14 S.Ct. 572, 574, 38 L.Ed. 470, 473; Holmes v. Uvalde National Bank, Tex.Civ.App., 222 S.W. 640- (er.ref.); Citizens National Bank v. Good Roads Gravel Co., Tex.Civ.App., 236 S.W. 153 (er. dis.); City National Bank v. Morgan, Tex.Civ.App., 258 S.W. 572; Carpenter v. Ferris National Bank, Tex.

Civ.App., 60 S.W.2d 495. While the Board of Directors had the power to authorize Abbas to borrow money on behalf of the Bank for the purpose of conducting its banking business in a legitimate and lawful manner, the Directors were not legally empowered to borrow or authorize Abbas to borrow money from appellant in order that the Bank might make a loan of the same to Walker in violation of the National Banking Laws as embraced in Title 12 U.S.C.A. §§ 24 and 84.

We recognize that the Bank would be estopped in equity to deny the validity or the binding force and effect of the agreement sued upon if in fact it received and retained the benefits resulting from the charges which were made against the account of appellant, as alleged by him. Appellant attempted to prove such allegation by the introduction of a great maze of debit and credit entries in the books of the Bank and in the accounts of various customers of the Bank, but in our opinion the evidence as a whole was completely lacking in probative force to serve as the basis for any such legal inference. Although some of such entries tended to show that the Bank might have received some character of a temporary benefit from one or more of the charges against the account of appellant, any such apparent benefit to the Bank was merely incidental and transitory, was of no significance and nothing more than an illusion and a snare, because the undisputed evidence shows conclusively, we think, that Walker, and Walker alone, actually received all the benefits of such charges to the extent of the full amount for which appellant sued in this case.

We do not deem it necessary to discuss any of the other legal questions involved on the appeal. From what has been said, it follows that in our opinion the judgment appealed from should be affirmed and it is accordingly so ordered. Affirmed.

Bank Permitted to Recover on Note Despite Bar of the Statute of Limitations in the State Where Suit Brought

One Appleyard executed a note in Texas payable to a Texas bank. Later he returned to North Carolina where the bank brought suit against him a few days less than four years after the note matured. Appleyard claimed the bank could not collect on the note because in North Carolina there was a three year statute of limitations covering the collection of such notes even though in Texas there was a four year period of limitation.

The court ruled in favor of the bank. The majority of the court reasoned that another North Carolina statute made the three year limitation period inapplicable during the time the defendant was outside the state. One of the judges in a concurring opinion reasoned that the North Carolina statute of limitations had no bearing on this case since the note was executed in Texas where there was a four year period of limitation. *Merchants & Planters National Bank of Sherman v. Appleyard,* Supreme Court of North Carolina, 77 S.E. 2d 783. The opinion of the court is as follows:

This is a civil action to recover on a promissory note.

The defendant Appleyard, on December 6, 1947, executed and delivered to the plaintiff a promissory note, not under seal, in the sum of $6,000, payable sixty days after date, to wit: February 4, 1948. At the time the note was executed, the defendant was a resident of the State of Texas, and the plaintiff, a national bank, was duly organized and engaged in the banking business at Sherman, Texas, where its principal office and place of business is located. The defendant prior to 1946 was a resident of North Carolina. He returned to this State in December 1951 and again became a resident thereof.

The statute of limitations on a note, not under seal, in the State of Texas, is four years. Vernon's Ann. Civ. St. Tex. art. 5527. This action was instituted on January 29, 1952, a few days prior to the expiration of four years from and after the maturity of the above note.

The defendant in his answer plead the three-year statute of limitations as provided in North Carolina by G.S. § 1-52, as a bar to plaintiff's cause of action.

When this cause came on for hearing, the plaintiff moved for judgment on the pleadings on the ground that the only defense raised by the defendant in his answer was the legal defense of the statute of limitations. The defendant admitted, through his counsel, that the only issue raised by his answer was his plea to the effect that the plaintiff's cause of action was barred by the North Carolina three-year statute of limitations. Whereupon, the court, after hearing argument of counsel, allowed the plaintiff's motion and entered judgment accordingly. The defendant appealed, assigning error.

Ratcliff, Vaughn, Hudson, Ferrell & Carter, Winston-Salem, for plaintiff, appellee.

Deal, Hutchins & Minor, Winston-Salem, for defendant, appellant.

DENNY, J.—The note in question having been executed in the State of Texas, the substantive rights of the partes are subject to the *lex loci.* However, since the plaintiff has instituted an action in this jurisdiction for the enforcement of its substantive rights against the defendant, its remedial rights are governed by the *lex fori.* McIntosh, North Carolina Practice and Procedure, section 103, page 104; Restatement, Conflict of Laws, section 603 (1934); 53 C.J.S., Limitations of Actions, § 28, p. 972; Wells v. Simonds Abrasive Co., 345 U.S. 514, 73 S.Ct. 856, 97 L. Ed. — (decided 18 May, 1953); Sayer v. Henderson, 225 N.C. 642, 35 S.E. 2d 875; Webb v. Webb, 222 N.C. 551, 23 S.E. 2d 897; Clodfelter v. Wells, 212 N.C. 823, 195 S.E. 11; Smith v. Gordon, 204 N.C. 695, 169 S.E. 634; Tieffenbrun v. Flannery, 198 N.C. 397, 151 S.E. 857, 68 A.L.R. 210; Vanderbilt v. Atlantic Coast Line R. R. Co., 188 N.C. 568, 125 S.E. 387, 52 A.L.R. 287; Patton v. W. M. Ritter Lbr. Co., 171 N.C. 837, 73 S.E. 167; Arrington v. Arrington, 127 N.C. 190, 37 S.E. 212, 52 L.R.A. 201, 80 Am. St. Rep. 791; Haws to Use of Thompson v. Cragie, 49 N.C. 394. Therefore, it must be conceded that the plaintiff's cause of action is barred unless section 1-21 of our General Statutes is applicable. This statute in pertinent part reads as follows: "If, when the cause of action accrues or judgment is rendered or docketed against a person, he is out of the State, action may be commenced, or judgment enforced, within the times herein limited, after the return of the person into this State, . . . the time of his absence shall not be a part of the time limited for the commencement of the action, or the enforcement of the judgment."

The plaintiff is not now and never was a resident of the State of North Carolina. The defendant was a resident of North Carolina for approximately thirteen years before moving to the State of Texas in 1946. However, he was a nonresident of this State on December 6, 1947 when he executed and delivered the note in controversy to the plaintiff and remained so until December, 1951.

The defendant was a resident of the State of Texas when the note was executed and when it matured. Therefore, he was not a resident of North Carolina when the cause of action arose; and the fact that the defendant had formerly lived in this State has no bearing on the interpretation or construction to be placed on the above statute.

The crucial question to be determined is whether the above statute is applicable to causes of action that arise out of the State and between parties who were nonresidents of this State when such actions arose, or whether the statute is applicable only to causes of action that arise in this State in favor of creditors residing therein. It appears that this precise question has not been decided by this Court. In our decisions in which the statute has been construed and applied by this Court, the creditors, or at least some of them, were residents of the State at the time the respective obligations were created and the causes of action arose.

Armfield v. Moore, 97 N.C. 34, 2 S.E. 347; Alpha Mills v. Watertown Steam Engine Co., 116 N.C. 797, 21 S.E. 917; Lee v. McKoy, 118 N.C. 518, 24 S.E. 210; Williams v. Iron Belt Building & Loan Association, 131 N.C. 267, 42 S.E. 607; Love v. West, 169 N.C. 13, 84 S.E. 1048; Cuthbertson v. People's Bank, 170 N.C. 531, 87 S.E. 333; Hill v. Lindsay, 210 N.C. 694, 188 S.E. 406.

In Armfield v. Moore, supra [97 N.C. 34, 2 S.E. 349], the defendant executed a note under seal to the plaintiffs in the town of Monroe, in this State, and at the time of its execution, the maker thereof, the defendant, was a nonresident of this State and remained so thereafter. The plaintiffs instituted an action to recover on the note more than ten years after its maturity, and the Court held that the defendant being a nonresident of the State would not be permitted to take advantage of the ten-year statute of limitations which he pleaded, in view of the provisions of the Code, § 162 (now G.S. § 1-21). The Court, in considering the statute, said: "The purpose is to prevent defendants from having the benefit of the lapse of time (the statute of limitation) while they permit debts against them past due to remain unpaid, or other causes of action against them to remain undischarged, and keep beyond the limits of the state and the jurisdiction of its courts, and thus prevent the person having the right to sue from doing so. It is not the policy or purpose of the state to drive its citizens directly or indirectly to seek their legal remedies abroad, or to encourage nonresidents to keep out of it, and beyond the jurisdiction of its courts, as would in some manner be the case if, by keeping out of the state, the debtor or person against whom a cause of action exists could avail himself of the lapse of time during his absence. The counsel for the appellant insisted in the argument that the statute under consideration does not embrace nonresidents of this state. We cannot so interpret it. The words 'any person' employed to designate the person to be affected and embraced by it, are very comprehensive, and there is nothing in its scope or purpose that excludes them."

We think it must be conceded that the statute under consideration was enacted for the primary purpose of tolling the statute of limitations in favor of the citizens and residents of this State whenever a cause of action arises in their favor, and the debtor, either resident or nonresident, is beyond the reach of process of our courts. Even so, this does not mean that our courts should not be open to a nonresident plaintiff to enforce a claim on a cause of action that is not barred in the jurisdiction where such cause of action arose, where the debtor has not been a resident of this State for the statutory time necessary to bar the action. Statutes like ours and those substantially and essentially in accord therewith, have been held to toll the statute in such cases where neither the plaintiff nor the defendant was a resident of the state of the forum at the time of the institution of the action and never was, as well as in those cases

where the obligation arose out of the state of the forum and the debtor had not resided in the state of the forum for a time sufficient to bar the action by the *lex fori*. Steen v. Swadley, 126 Ala. 616, 28 So. 620; Western Coal & Mining Co. v. Hilvert, 63 Ariz. 171, 160 P.2d 331; McKee v. Dodd, 152 Cal. 637, 93 P. 854, 14 L.R.A.,N.S., 780, 125 Am. St. Rep. 82; Cvecich v. Giardino, 37 Cal. App.2d 394, 99 P.2d 573; Simon v. Wilnes, 97 Colo. 78, 47 P.2d 406; Newton v. Mann, 111 Colo. 76, 137 P.2d 776, 147 A.L.R. 767; Hatch v. Spofford, 24 Conn. 432; Jones v. Wells, 2 Houst. 209, 7 Del. 209; Van Deren v. Lory, 87 Fla. 422, 100 So. 794; West v. Theis, 15 Idaho 167, 96 P. 932, 17 L.R.A.,N.S., 472, 128 Am. St. Rep. 58 (Idaho now has a provision in its statute, I.C. § 5-239, which prevents recovery on a claim in that State, if barred in the jurisdiction where the cause of action arose); Ross v. Rees, 55 Iowa 296, 7 N.W. 611; McNamara v. McAllister, 150 Iowa, 243, 130 N.W. 26, 34 L.R.A.,N.S., 436 Ann. Cas. 1912D, 463;Bonifant v. Doniphan, 3 Kan. 26 (Kansas has amended its statute, G.S.1949, 60-310, so as not to toll the statute of limitations where the plaintiff and defendants were nonresidents of the State when the cause of action accrued and such cause of action is barred in the State where it arose, Bruner v. Martin, 76 Kan. 862, 93 P. 165, 14 L.R.A.,N.S., 775, 123 Am. St. Rep. 172, 14 Ann. Cas. 39); Thompson v. Reed, 75 Me. 404; Frye v. Parker, 84 Me. 251, 24 A. 844; Mason v. Union Mills Paper Co., 81 Md. 446, 32 A. 311, 29 L.R.A. 273, 48 Am. St. Rep. 524; John v. John, 307 Mass. 514, 30 N.E. 2d 542 (it is pointed out in this case that the statute, G.L. (Ter. Ed.) c. 260, § 9, contains a provision to the effect that an action cannot be maintained in Massachusetts on a cause of action arising out of the State, if such cause of action is barred in the State where it arose); Belden v. Blackman, 118 Mich. 448, 76 N.W. 979; Tagart v. Indiana, 15 Mo. 209 (statute in Missouri, V.A.M.S. § 516.200, has been changed so as to apply only to any debtor who is a resident of that State, Koppel v. Rowland, 319 Mo. 602, 4 S.W.2d 816); Hartley v. Crawford, 12 Neb. 471, 11 N.W. 729; Paine v. Drew, 44 N.H. 306; In re Goldsworthy's Estate, 45 N.M. 406, 115 P.2d 627; 148 A.L.R. 722; Ruggles v. Keeler, 3 Johns., N.Y., 263, 3 Am.Dec. 482; Meyers v. Credit Lyonnais, 259 N.Y. 399, 182 N.E. 61, 83 A.L.R. 268 (this case expressly disapproves Garrison v. Newman, 222 App.Div. 498, 227 N.Y.S. 78, which held that where the creditor and debtor were nonresidents and the cause of action accrued outside the State of New York, that the exception to the statute, Civil Practice Act, § 13, did not apply); Bean v. Rumrill, 69 Okl. 300, 172 P. 452; Crocker v. Arey, 3 R.I. 178; McConnell v. Spicker, 15 S.D. 98, 87 N.W. 574; Raymond v. Barnard, 71 S.D. 630, 28 N.W.2d 700; Kempe v. Bader, 86 Tenn. 189, 6 S.W. 126 (overruling Barbour v. Erwin, 14 Tenn. 716, 721); Burnes v. Crane, 1 Utah 179. Seen Annotations 83 A.L.R. 271; 148 A.L.R. 732 and 17 A.L.R.2d 502.

In the recent case of Howle v. Twin States Express, Inc., 237 N.C. 667, 75 S.E.2d 732, Winborne, J., assembled our decisions to the effect that a nonresident has the right to bring an action in our courts as one of the privileges guaranteed the citizens of the several states by the Constitution of the United States, Article IV, section 2. A nonresident is entitled to the benefit of statutory provisions such as those contained in G.S. § 1-21, and may bring his action in the state of the forum under the same terms and conditions which would have been applicable to him if he had been a resident thereof at the time the action arose.

Let us consider carefully that part of G.S. § 1-21 which is applicable to this case. A casual examination of the statute might lead to the conclusion that the debtor must have been a resident of this State or temporarily residing therein at the time the obligation was created and upon which the cause of action arose since we usually do not speak of returning to a place we have never been. The origin of the statute and the construction placed upon some of the words and phrases contained therein, by other courts, may be helpful to us in answering the question posed on this appeal. The Statute of 4 & 5 Anne, chapter 16, section 19, provided in substance that if any person against whom there should be any cause of action was, at the time such action accrued, beyond the seas, the action might be brought against him on his return within the time limited for bringing such action. 54 C.J.S., Limitations of Actions, § 208, p. 229, et seq. The original English statute may be found in English Statutes at Large, Volume 4, page 207. The term "beyond the seas," used in the English statute, was construed by the English courts to be synonymous with "beyond the realm," or "out of the realm." Since we have the several states, each with its own judicial system, each state is a separate realm in the sense in which the term "beyond the seas" was used in the English statute. But with our citizens constantly engaged in interstate commerce among the several states, and nonresident debtors contracting with citizens of the several states, the term "out of the state," having been substituted for the term "beyond the seas," in most of the statutes now in effect in the several states; the courts, generally, in effect and in some cases expressly, have held that the words "return of the person to this state," or "into the state," mean "return to the state," or "come into the state." Likewise, the words "absence" and "return" do not restrict the operation of the exception to those only who have been in the state. Otherwise, the pertinent provisions of the statute, which we are considering would not toll the statute of limitations and stop it from running in favor of a nonresident debtor who had never been a resident of this State. Steen v. Swadley, supra; Van Deren v. Lory, supra; West v. Theis, supra; Paine v. Drew, supra; Meyers v. Credit Lyonnais, supra; Cvecich v. Giardino, supra; Annotation 17 A.L.R.2d 506; 34 Am.Jur., Limitations of Actions, section 215, page 172, et seq.; 54 C.J.S., Limita-

tions of Actions, § 210 (b), p. 231. The last cited authority states: "The word 'return,' used in the statute to indicate the starting point of the running of the time, cannot restrict the operation of the exception to those only who have been in the state."

In the early case of Ruggles v. Keeler, supra, Chief Justice Kent used this language: "Whether the defendant be a resident of this state, and only absent for a time, or whether he resides altogether out of the state, is immaterial. He is equally within the proviso. If the cause of action arose out of the state, it is sufficient to save the statute from running in favor of the party to be charged, until he comes within our jurisdiction." This Court reached a similar conclusion in Green v. Hartford Life Insurance Co., 139 N.C. 309, 151 S.E. 887, 1 L.R.A., N.S., 623; Williams v. Iron Belt Building & Loan Association, supra; and Cuthbertson v. People's Bank, supra.

Likewise, with respect to actions accruing out of the state of the forum, the Supreme Court of Arizona, in the case of Western Coal & Mining Co. v. Hilvert, supra [63 Ariz. 171, 160 P.2d 336], stated the majority view in the following language: "To construe the act as limited to claims arising in this state would be a strained and narrow construction. It would require us to add to the broad scope of the act applying to any 'person against whom there shall be a cause of action' the limiting words 'arising in this state.' If the action was not barred by the law of the place of the breach or residence of the defendant, we see no reason in justice or policy why we should construe this act to extend the tolling provisions of the statute only to causes of action arising within this state, the legislature having declared no such purpose." The Arizona Court, in its opinion, quoted with approval what was said in the early case of Hartley v. Crawford, supra, to the effect that to hold that the statute "applies only to causes of action accruing in this state, 'or in behalf of one of our citizens' would be exceedingly forced, and entirely unsupported, as we think, by reason or authority. The language of the statute is general, and applies to all personal causes of action to which a bar is provided in the preceding sections."

The States of Mississippi and Pennsylvania have limited the tolling of their statutes of limitation by amending statutes similar to the one under consideration so as to make them applicable only to causes of action arising within those respective States. Code Miss.1942, § 740; 12 P.S.Pa. § 40, Wright v. Mordaunt, 77 Miss. 537, 27 So. 640, 78 Am.St.Rep. 536; United States Fidelity & G. Co. v. Ransom, 192 Miss. 286, 5 So.2d 238; In re Shaffer's Estate, 228 Pa. 36, 76 A. 716; Continental Illinois Nat. Bank & Trust Co. v. Holmes, D.C., 21 F.Supp. 309.

The State of Minnesota has enacted legislation to the effect that where a cause of action has arisen out of the State, an action thereon

cannot be maintained within that State if it is barred by the laws of the State or foreign country where it arose, unless the cause of action from the time it accrued had been in favor of a citizen of Minnesota. M.S.A. § 541.14. Powers Mercantile Co. v. Blethen, 91 Minn. 339, 97 N.W. 1056. The State of Oregon, by legislative action, has likewise limited actions that may be brought on causes of actions arising outside of the State to those that are not barred in the jurisdiction where they arose. O.C.L.A. § 1-224. McCormick v. Blanchard, 7 Or. 232; In re Wemple's Estate, 92 Or. 41, 179 P. 674. In line with this view, New York's Civil Practice Act, § 13, provides: "Where a cause of action arises outside of this state, an action cannot be brought in a court of this state to enforce such cause of action after the expiration of the time limited by the laws . . . of the state or country where the cause of action arose, for bringing an action upon such cause of action, except that where the cause of action originally accrued in favor of a resident of this state." Thompson's Laws of New York 1939, Part II.

The statute in Illinois, in pertinent part, is identical with ours, however, it contains this proviso: "But the foregoing provisions of this section shall not apply to any case, when, at the time the cause of action accrued or shall accrue, neither the party against nor in favor of whom the same accrued or shall accrue, were or are residents of this state." S.H.A. ch. 83, § 19. Mitchell v. Comstock, 305 Ill.App. 360, 27 N.E.2d 620.

The minority view, holding that a statute similar to ours, does not apply to actions accruing outside the state between a nonresident creditor and a nonresident debtor, has been followed by New Jersey and Texas. Shapiro v. Friedman, 132 N.J.L. 456, 41 A.2d 10; Stone v. Phillips, 142 Tex. 216, 176 S.W.2d 932.

In the case of Shapiro v. Friedman, supra [132 N.J.L. 456, 41 A.2d 12], the Court said: "These statutes, in our view, are predicated on the idea of saving a resident creditor's action against a debtor who is nonresident when the action accrues or who leaves the state after the accrual and before the statute of limitations has run. It is true that the majority of the states have construed statutes of similar import differently on this point. See 83 A.L.R. p. 273; also Id., p. 276; 148 A.L.R. p. 732, p. 736. Some of the statutes, we gather from reading the reports, are quite different from our own. Meyers v. Credit Lyonnais Co., 259 N.Y. 399, 182 N.E. 61, 83 A.L.R. 268."

Other states have also added provisions to their statutes which take them out of the majority or minority line of cases, among them being Georgia, Kentucky, Vermont, and Wisconsin. Moore v. Carroll, 54 Ga. 126; Sword v. Scott, 293 Ky. 630, 169 S.W.2d 825; Troll v. Hanauer, 57 Vt. 139; National Bank of Oshkosh v. Davis, 100 Wis. 240, 75 N.W. 1005,

1006. It will also be noted that many jurisdictions, while adhering to the majority view, have adopted legislation which may prevent recovery on a cause of action arising out of the state of the forum, if such action, at the time of its institution, was barred in the jurisdiction in which it arose. Whether we should take similar action is a matter for the Legislature. Be that as it may, the cause of action involved herein was not barred in the jurisdiction in which it arose at the time the present action was instituted.

After a careful review and consideration of the authorities bearing on the question presented, we are inclined to follow the majority view.

The judgment of the court below is

Affirmed.

BARNHILL, Justice (concurring in result).

The court below rendered judgment on the pleadings. This in itself presents a question worthy of some consideration. The answer contains an unequivocal denial that defendant is indebted to plaintiff in any amount. He likewise pleads our three-year statute of limitations, and it appears that this action was instituted more than three years after plaintiff's cause of action accrued. G.S. §§ 1-15, 1-52. While the briefs filed and arguments made by counsel disclose that plaintiff is relying on the provisions of G.S. § 1-21, plaintiff does not allege in reply that the statute was tolled by the fact defendant was "out of the State" when its cause of action arose and did not become a resident of this State until December 1951, shortly before the institution of this action.

We have consistently held that a litigant must plead the provisions of our prescription statutes upon which he relies. The statute so provides. G.S. § 1-15. Why should not that rule apply here? Le Mieux Bros. Corporation v. Armstrong, 5 Cir., 91 F.2d 445.

Decision in the court below was made to turn on our three-year statute of limitations. Since this action was not instituted until almost four years after plaintiff's cause of action arose, it is apparent the trial judge concluded that the provision of G.S. § 1-21, which tolls the statute if the debtor is out of the State at the time the cause of action arose, is controlling. If that be the case, then the beginning date of the three-year period is the date of the debtor's return to the state rather than the date the cause of action accrued. G.S. § 1-15. That is the rationale of the majority opinion.

The majority conclude that G.S. § 1-21 applies even when both the creditor and debtor were nonresidents when the plaintiff's cause of action accrued and the cause of action arose in the State of their residence. I find it utterly impossible to concur in this conclusion. While I concur in the affirmance of the judgment, my concurrence is bottomed on the reasons hereinafter stated.

I readily concede that the majority view follows the apparent weight of authority which is the usual practice when the exact question presented has not been decided in this State. However, in my opinion, there has been more unsound, superficial, and illogical writing by the courts in construing provisions somewhat similar to those contained in G.S. § 1-21 than on any other subject it has been my privilege to investigate. There has been as much judicial flirtation on this question as on any in the books.

In 1808, Kent, C. J., in his opinion in Ruggles v. Keeler, 3 Johns, N.Y., 263, 3 Am.Dec. 482, construing the New York statute, held that a statute of limitations of a State (Conn.) in which the cause of action accrued could not be pleaded in a suit instituted in New York; that "out of the State" as used in the New York statute tolling the statute of limitations applies to all foreigners; and that "after the return" embraces those who enter the State for the first time. He gave no reason for his conclusions and engaged in no analytical discussion of the New York statute. Instead, the statements are more or less categorical in nature.

Since that time the courts of the several States (except Texas, New Jersey, and Kansas) which have applied similar though not identical statutes, have picked up and followed the opinion in the Ruggles case. This has been done in most cases with perfunctory or superficial discussion.

These cases, relied on by the majority, hold that the term "out of the State" has a universal meaning, notwithstanding the context of its use, and includes foreigners who have never been within the State; and "after the return of the person (debtor) into this State" includes not only those who depart and later return but also any and all who come into the State for the first time. "The word 'return' as used in the statutes does not confine the exception to residents, and a nonresident coming into the state for the first time after a cause of action has accrued is regarded as returning to the state." 54 C.J.S., Limitations of Actions, § 212, p. 237.

To my mind to say that a man was "out of the State" at a certain time or that he "returned" to the State on a certain date, when theretofore he had never been in the State, gives these terms a connotation which is strained, unnatural, and unrealistic, and wholly unsupported by reason or logic.

I must confess that my mental reaction to such conclusions invites much writing. However, I shall attempt to confine my comment to the subject at hand.

It should be noted in the beginning that the cases cited and relied on are clearly distinguishable and cannot be considered authoritative on the question here presented. While I may be the one who is entirely off

the beam, I cannot follow the logic of these cases or concede that they are sufficiently in point to be controlling.

Instead, I prefer to follow the well-reasoned opinions in Stone v. Phillips, 142 Tex. 216, 176 S.W.2d 932; Shapiro v. Friedman, 132 N.J.L. 456, 41 A.2d 10; and Bruner v. Martin, 76 Kan. 862, 93 P. 165, 14 L.R.A., N.S., 775.

In Armfield v. Moore, 97 N.C. 34, 2 S.E. 347, and Lee v. McKoy, 118 N.C. 518, plaintiffs were residents of North Carolina and the cause accrued here. In Ewbank v. Lyman, 170 N.C. 507, 87 S.E. 348, the action was to vacate a deed for fraud. It was of course necessary to maintain that action in this State. In Hill v. Lindsay, 210 N.C. 694, 188 S.E. 406, at least one of the plaintiffs was a resident.

The cases cited from other jurisdictions involve statutes which vary so greatly in their wording that decisions relating thereto must be considered with regard to the particular phraseology employed in creating them. 34 A.J. 173; 83 A.L.R. 272; 17 A.L.R.2d 503.

In many of the cases the plaintiff was a resident of the State of the forum, and the cause of action accrued in that State. With these decisions I am in full accord. A creditor is not required to pursue his debtor from State to State. It is instead the duty of the debtor to seek out his creditor and pay him what is due. If the debtor is a nonresident or is out of the State at the time the cause of action accrues, the creditor may wait for him to return to the State, and the statute is tolled so long as the debtor is beyond the jurisdiction of the local courts. To my mind that is the very purpose of the exceptive provisions contained in G.S. § 1-21.

There are only a few cases in which both plaintiff and defendant were nonresidents of the State of the forum when the cause of action accrued, and the plaintiff was a nonresident of the State of the forum at the time suit was instituted. In these few cases the majority of the courts apply the same rule. Apparently only Texas, Stone v. Phillips, supra; New Jersey, Shapiro v. Friedman, supra; and Kansas, Bruner v. Martin, supra, take the opposite view in accord with my way of thinking. See also Skaggs v. Fyffe, 299 Ky. 751, 187 S.W.2d 281; Wright v. Mordaunt, 77 Miss. 537, 27 So. 640; In re Shaffer's Estate, 228 Pa. 36, 76 A. 716.

Even those cases in which the facts are substantially on all fours with the instant case, in which the majority rule is applied, are factually distinguishable. Here defendant was a resident of plaintiff's home State and amenable to process issued out of a court of competent jurisdiction of that State for three years and ten months next after plaintiff's cause of action accrued. Notwithstanding the fact plaintiff had the right to sue and defendant was subject to the service of process, it delayed action more than the three-year period proscribed by our statute.

So then, the question comes to this: Where a cause of action on an unsealed promissory note accrues in favor of a Texas bank against a citizen of Texas who continues to reside in Texas thereafter for three years and ten months, amenable to process issued by a Texas court of competent jurisdiction, and then comes into this State where the bank appears and institutes an action on its note just seven days less than four years after its cause of action accrued, does our three-year statute, G.S. § 1-52, apply and was the running of said statute tolled by reason of the fact the defendant was out of this State when the cause of action accrued and came into this State less than three years prior to the institution of said action, G.S. § 1-21?

In my opinion the answer should be in the negative. Our statute, when correctly construed, is not controlling. Instead, we must look to the prescription statute of the State in which the parties resided at the time the contract was made and the cause of action accrued to determine whether plaintiff's claim is barred. That was the statute in the contemplation of the parties when the contract was made.

The fundamental principle of statutory construction is to give effect to the intent of the Legislature, for the heart of the law is the intention of the law-making body. Strict adherence to literalness is the cardinal sin of statutory construction. And so we are not required to accord the language used an unnecessarily literal meaning. Context and purpose are controlling and the right to be protected or the evil to be remedied is to be accorded prime consideration. Statutory provisions should be construed in consonance with the objects and purposes in contemplation at the time of their adoption. Perry v. Stancil, 237 N.C. 442, 75 S.E.2d 512; In re Yelton: Advisory Opinion, 223 N.C. 845, 28 S.E.2d 567, 571.

Furthermore, "An inhibition or prohibition usually extends no farther than the reason on which it is founded. *Cessante ratione, cessat ipsa lex.*" In re Yelton, supra.

To these general rules I may add with confidence that in proper cases such as this the limitations upon the power of the law-making agency in large measure determines the intent, purpose, and scope of the language used, for we may not assume the Legislature intentionally exceeded its law-making authority.

G.S. § 1-15 provides that "Civil actions can only be commenced within the periods prescribed in this chapter, after the cause of action has accrued, except where in special cases a different limitation is prescribed by statute." G.S. § 1-21, which is a part of the same statute and must be considered *in pari materia*, is in the nature of a proviso and is one of the "special cases" excepted in G.S. § 1-15. G.S. § 1-15 provides the general rule and G.S. § 1-21 sets forth the exceptions thereto.

So then, in effect, the pertinent part of our statute reads as follows:

"Civil actions can only be commenced within the periods prescribed in this chapter, after the cause of action has accrued," provided, however, "if, when the cause of action accrues . . . against a person, he is out of the State, action may be commenced . . . within the times herein limited, after the return of the person into this State. . . ."

The General Assembly in enacting this statute was legislating for the people of this State and regulating their right to maintain actions in our courts. The statute is a declaration of local policy without force or effect beyond the borders of the State. It was designed and intended to precribe, regulate, and protect the rights of residents. This was the extent of its legislative authority.

"The object of the section was for the protection of domestic creditors . . . And it was intended to protect them from the inconvenience and loss, to which they would be exposed by the absence of their debtors and consequent immunity of the latter from process and judgment." Stone v. Phillips, supra [142 Tex. 216, 176 S.W.2d 934]; Wilson v. Daggett, 88 Tex. 375, 31 S.W. 618.

Its purpose is to secure to plaintiff the same time in which to commence an action against an absent or nonresident defendant that he would have if defendant were an actual resident of the State. 54 C.J.S., Limitations of Actions, § 211, p. 232; McLaughlin v. Aetna Life Ins. Co., 221 Mich. 479, 191 N.W. 224.

The exceptive provision is based on the premise that the statute was intended to protect or save the action because it accrued here and the debtor is not to be benefited because he leaves this State. Shapiro v. Friedman, supra. It contemplates an absence from the State that will prevent plaintiff from reducing his cause of action to a judgment *in personam,* Niblack v. Goodman, 67 Ind. 174, and its purpose is to prevent the defendant from defeating plaintiff's right to prosecute his action. Embrey v. Jemison, 131 U.S. 336, 9 S.Ct. 776, 33 L.Ed. 172.

On the one hand, the statute is intended to limit the right of a plaintiff to institute his action, and it specifies the time limitation in respect to each and every type of action—three years when the action is bottomed on an unsealed promissory note as in this case. On the other hand, it is designed to prevent the debtor from evading the jurisdiction of the court by departing the State either before or after the cause of action accrues. It thus assures the plaintiff the full time stipulated in the statute in which to institute his action.

In construing similar Acts, the Courts, in my opinion, have placed undue emphasis upon the terms "out of the State" and "return into the State" and have overlooked or failed to consider the limiting provision, "If, when the cause of action accrues." That is the key provision of the

section. Determine what causes of action it includes and you solve the meaning and purpose of the whole section.

In determining what causes of action are included in this provision, neither the removal of defendant to this State after plaintiff's cause of action accrued in Texas nor the length of time he had been in this State when this action was instituted is material. The decisive facts are these: The note described in the complaint and plaintiff's cause of action bottomed thereon are items of property which belong to a nonresident; and the plaintiff is now, and was at the time its cause of action accrued in its home state, a nonresident of this State.

The note held by plaintiff is property. Likewise, the cause of action created by defendant's default in the payment thereof is property. It is a chose in action. "A vested right of action is property in the same sense in which tangible things are property . . ." Williams v. Atlantic Coast Line R. R. Co., 153 N.C. 360, 69 S.E. 402, 403.

This property which is involved in this litigation constitutes a part of the mass of property located in the State of Texas. In respect thereto, there was no right to be protected or evil to be remedied by our Legislature. It is no concern of our Legislature as to when a nonresident shall institute his action. Nor is a nonresident disadvantaged because his debtor is beyond the juridiction of our courts. Why then should the Legislature undertake to provide for the tolling of our prescription statute in behalf of one who is not himself within the State and has no cause to come to this State to institute his action so long as his debtor is "out of the State?"

Plaintiff was not inconvenienced by the fact defendant was out of the State of North Carolina. From the date defendant's cause of action accrued until the date defendant established residence in this State, it was unaffected by defendant's nonresidence here. During the full time he was amenable to process and plaintiff was free to prosecute its action in its home State. It was defendant's departure from Texas that has caused plaintiff inconvenience and loss.

Furthermore, our General Assembly was without authority to legislate in respect to property located in another State or to regulate the rights of nonresidents possessing a cause of action against one of its debtors, which cause accrued in the State of their residence.

Of necessity the absence of any right to be protected or any evil to be remedied by our Legislature in respect to property located in another State and its want of authority to legislate in respect thereto have a direct bearing on the meaning of the language used.

Strangely enough, however, no court, so far as I have been able to ascertain, has considered the limitations upon the authority of the law-

making agency of government in determining the meaning of similar language used in prescription statutes.

Our statute was designed and intended to prescribe, regulate, and protect the rights of residents. That was the extent of the legislative authority of the General Assembly. I cannot conceive that it intended to undertake to legislate in respect to Texas property, or regulate the rights of a Texas bank against one of its Texas debtors, or to protect such bank against its inability to procure service of summons on one of its debtors without suffering the inconvenience of going to another State. To my mind there is no conceivable reason why our General Assembly should undertake to provide for the tolling of our prescription statute in behalf of one who is not himself in the State and has no cause to come to this State to institute his action so long as his debtor is "out of the State." If our General Assembly intended that G.S. § 1-21 should have that force and effect, it was indeed solicitous of the rights of nonresidents.

So then, when we consider the legitimate objective of the statute and the limitations upon the law-making power of our General Assembly, the language used, by clear implication, limits the provisions of the statute to a resident creditor possessing a cause of action against one who was in the State when the contract was made or the liability was incurred but left the State before the cause of action accrued or after its accrual but before the statute of limitations had run its course. Otis v. Bennett, 302 U.S. 727, 58 S.Ct. 48, 82 L.Ed. 561; BancoKentucky Co.'s Receiver v. Nat. Bank of Kentucky's Receiver, 281 Ky. 784, 137 S.W.2d 357; Daly v. Power, 248 Ky. 533, 59 S.W.2d 10; Carter v. Burns, 332 Mo. 1128, 61 S.W.2d 933; 54 C.J.S., Limitations of Actions, § 212, p. 235.

"If, when the cause of action accrues" means "if, when the cause of action accrues in this State." This meaning is as implicit as if the term "in this State" was actually written in the statute. The other language in the statute fortifies this conclusion. We do not ordinarily speak of a person as being out of the State unless he is customarily in the State, and "return" ordinarily means "come back to."

At first blush the answer that the statute regulates procedure in the courts of the State and not the rights of the parties would seem to be sufficient, but such is not its purpose or effect. The statute provides that "civil actions can only be commenced within the periods prescribed within this chapter after the cause of action has accrued. . . ." G.S. § 1-15. Since a civil action is a proceeding to enforce a cause of action, and a cause of action is, in a legal sense, property, it would seem to be clear that the statute constitutes a limitation of a property right. Expiration of the time limitation destroys the property. It ceases to exist.

However, the majority hold that our statute applies and is controlling under the *lex fori* doctrine on the theory it is adjective or procedural

law. On this phase of the case, at least, the majority opinion is sustained by the cases cited. If those cases settle any one legal question, it is that the prescription statutes of the State of the forum are procedural in nature and are controlling in cases where the cause of action accrued in some other State. Unfortunately the judicial mind sometimes becomes closed. Apparently on this question it has become closed, clamped down, and padlocked. While some of the cases are distinguishable, there is no escaping the fact that a large majority of the courts which have ruled on the question so hold. There is little, if any, reason advanced in support of the conclusion. The courts, since the decision in Ruggles v. Keeler, supra, have been content to make a categorical statement of the rule as set forth in that case. In this conclusion I am unable to concur.

Our statute prescribes no procedure. It cuts off the right as well as the remedy. It imposes a limitation upon the right of a plaintiff to reduce his claim to a judgment *in personam*, and G.S. § 1-21 merely fixes the beginning date of the limitation in the event the debtor is out of the State when the cause of action accrues.

Strictly speaking, our statute does not create a condition precedent. It does not enter the picture unless pleaded. Yet, when pleaded, it immediately becomes a condition precedent. The plaintiff may recover only in the event he proves that he instituted his action within the time prescribed by the statute. If the action was not instituted within the time precribed, plaintiff's right to judgment on its claim is destroyed and his action must be dismissed. Vail v. Vail, 233 N.C. 109, 63 S.E.2d 202; Marks v. McLeod, 203 N.C. 257, 165 S.E. 693; Southerland v. Crump, 199 N.C. 111, 153 S.E. 845; Phillips v. Penland, 196 N.C. 425, 147 S.E. 731.

The plaintiff did not come to this State and institute its action under authority of any provision contained in our statutes. It came under authority of the "Privileges and Immunities" provision of art. IV, sec. 2, of the United States Constitution. Since its cause of action is a transitory one, it was privileged to institute its action and enforce its rights in respect thereto in the courts of this State where it could procure service of summons. Its claim is unaffected by the laws of this State. The only requirement to which it is subjected is the requirement that in prosecuting its action it follow the procedural law of this State. Clodfelter v. Wells, 212 N.C. 823, 195 S.E. 11.

In this connection I may note that plaintiff, a corporation, is not a citizen of the United States within the meaning of art. IV, sec. 2, of the Federal Constitution. Bode v. Flynn, 213 Wis. 509, 252 N.W. 284, 94 A.L.R. 480; Blake v. McClung, 172 U.S. 239, 19 S.Ct. 165, 43 L.Ed. 432. However, we have always extended to foreign corporations the courtesy of the use of our courts, and I willingly treat plaintiff as a citizen for the

purpose of this discussion, for it is immaterial whether it is here by comity or as a matter of right. In either event it is bound only by our law of procedure of which, in my opinion, the statute of limitations forms no part.

The Texas General Assembly which possessed legislative authority over plaintiff and its property has declared that plaintiff must exercise its right to reduce its claim to a judgment *in personam* within four years after its cause of action accrued. But this Court say no. It had three years from and after defendant established residence in this State, irrespective of the date of the accrual of its cause of action in the State of Texas. In this conclusion I cannot concur. As heretofore stated, in my opinion our statute has no application to the facts in this case. We must, instead, look to the prescription statute of Texas to ascertain the merits of any contention that plaintiff's cause of action is now stale. Since the plaintiff brought to this State a live claim and instituted its action within the time allowed by the Texas statute, it has the right to maintain its cause in the courts of this State.

If we adopt the view of the majority opinion, then we open the door for serious discrimination in favor of nonresidents. It makes no difference how old a claim may be or what opportunity a nonresident claimant has had to reduce his claim to judgment, our statute is tolled in his behalf so long as the debtor remains out of this State, and it begins to run anew as soon as he removes to this State, whether the claim has been stale for one year, ten years, or twenty years under the *lex domicilii*. Thus, we open the doors of our courts for the enforcement of a claim of a nonresident which is barred by the laws of the State in which the cause of action accrued. The removal of the debtor to this State resurrects the claim and gives it new life so that it may be enforced in the courts of this State though long since dead in the State of its origin.

It has been suggested, however, that we would not entertain a claim which is stale under the *lex fori*. But we cannot blow hot and cold on the same question by applying the *lex loci* in one case and the *lex fori* in another. That is what that policy would require, for we would be compelled to look to the *lex domicilii* in every case to determine whether the claim is stale. If so, the *lex loci* would control decision. If not, our statute would apply. We must choose one course or the other.

The construction of the statute I advocate would establish a sound, consistent, and uniform rule which would not discriminate against citizens of this or any other State. A nonresident possessing a transitory cause of action against a citizen of this State may maintain an action thereon in the courts of this State if it is a live claim under the *lex domicilii* where the cause accrued. If it is stale under such laws, an action thereon cannot be maintained in the courts of this State. Happily at

least the decisions of the courts of Texas, New Jersey, and Kansas are in accord with and support my views.

To summarize, I am of the opinion that:

(1) The residence or nonresidence of defendant in this State is immaterial.

(2) The nonresidence of plaintiff and the accrual of its cause of action in the State of Texas are the vital, determinative facts.

(3) Our statute of limitations has no application to the facts in this case. Instead, the rights of the parties are controlled by the prescription statute of the State where the contract was made and the cause accrued.

(4) It is not the intent or purpose of our prescription statute to resurrect and give new life to a cause of action which is stale under the law of the State in which the cause accrued. A construction thereof which would give it that force and effect is unsound and should not be adopted.

(5) Plaintiff's cause of action is property located in and subject to the laws of Texas.

(6) Since its cause of action is a transitory one and is not barred by the prescription statutes of Texas, the plaintiff has the right to maintain its action in the courts of this State and is, on the admissions made in the answer, entitled to judgment.

It follows that I vote to affirm for the reason plaintiff's claim is a live one under the laws of Texas where it now exists as property, and the debt is admitted, and for no other reason.

Fraudulent Acts of Manager Prevent Bank From Qualifying as Holder in Due Course

A case has been reported recently where the fraudulent acts of a bank's manager proved costly to the bank in two ways. The bank manager and one Davis persuaded Arnold, an elderly woman, to form a partnership with Davis, who executed three notes payable to the bank on behalf of the partnership. It appeared that the bank manager and Davis had conspired to defraud Arnold out of her savings by various schemes. Later the bank sought to enforce the notes against Arnold who not only denied liability on the notes but claimed the bank was liable to her for paying out partnership funds to Davis without the bank manager's countersignature in violation of the bank's deposit agreement. The court ruled against the bank on both counts.

It stated that the bank as payee of the notes could have been a holder in due course but was not such a holder because the notes were taken by the manager in bad faith which was imputable to the bank. *Matanuska Valley Bank v. Arnold et al.* District Court, Alaska, Third Division, Anchorage, 116 Fed.Supp. 32. The opinion of the court is as follows:

FOLTA, D. J.—Plaintiff seeks to recover approximately $11,000 on three negotiable notes, executed in the name of the Davis Construction Co. by the defendant Willard Davis as a member thereof, and payable to the order of the plaintiff. The defendant Arnold contends that she is not liable on the notes because they were executed by her copartner not only without authority but pursuant to a scheme to defraud her devised by her copartner, the defendant Davis, and the plaintiff, and also because she was released by the plaintiff. The defendant Davis has defaulted. The defendant Arnold has also interposed a counterclaim for $3,949.89—the aggregate sum of checks drawn on the partnership account and honored by the plaintiff bank, allegedly pursuant to the scheme aforesaid and in violation of the agreement between the bank and the defendants which, among other things, required, as a prerequisite to charging the partnership account, the counter-signature of Maze, manager of the bank, to all checks.

Upon representations made to the defendant Arnold by Maze, manager of plaintiff, and by her codefendant Davis, that Davis could not obtain a performance bond for the contract awarded him or buy sufficient materials to commence and prosecute the job until the receipt of work progress payments, and that a substantial profit could be made, she was induced to enter into a partnership with Davis on July 17, 1950, the sole object of which was the completion of the construction contract referred to. It thus appears that she was induced to join the venture because of her financial ability. The agreement requires equal contributions of capital, the keeping of books and records, and expressly provides that all checks drawn upon the funds of the firm shall be signed by Davis and countersigned by Maze.

On July 24, October 13 and October 24, 1950, the defendant Arnold personally executed notes in the sum of $5,000 each, payable to the plaintiff. The first was lost, the second was apparently paid on November 20, 1950; the third was paid by the note of July 12, 1951. It should be noted at this juncture that the action is not based on any of the foregoing three notes. On March 16, July 12 and October 17, 1951, the defendant Davis executed notes for $3,000, $5,100 and $3,000 respectively. It is asserted that the note of July 12, 1951 is a renewal of the note of October 24, 1950.

Following the execution of the partnership agreement, it appears that, with the connivance of Maze, Davis engaged in several other jobs, two of them for Maze, mingled the funds received from them, neglected the partnership job, left the Territory for a considerable period of time, failed to keep records, charged wages to the partnership job for the time he was engaged on the other jobs, avoided his copartner when she attempted to contact him and finally defaulted. In the light of these acts, the testimony of Davis assumes especial significance. He was evasive and pretended to be unable to recall matters obviously within his recollection to such an extent that the Court can give little weight to his testimony. The failure to keep records, in violation of an express obligation to do so, is under the circumstances proof of fraud. Indeed, it is difficult to avoid the conclusion that the two conspired to defraud an elderly woman of her savings.

Maze did not appear as a witness, presumably because, in the meantime, he had been convicted of embezzling approximately $150,000 from the bank. That he was a party to the alleged scheme to defraud the defendant Arnold cannot be gainsaid in view of his permitting the commingling of funds, his payment of the checks drawn by Davis without his counter-signature in violation of the express terms of the agreement, and his attempts during that time to allay the well founded suspicions of the defendant Arnold.

The defendant Arnold's denial of liability is predicated on the alleged lack of authority, express or implied, on the part of Davis to bind the firm, because it was a joint adventure and was not engaged in trading, Cf. Federal Service Finance Corp. v. Bishop National Bank, 9 Cir., 190 F.2d 442, all of which, she asserts was well known to the bank, and also on her exhibit "G", a letter from the bank, which she contends constitutes a release, in which it was stated that she was no longer indebted to the bank because the "last note" of October 24, 1950, was paid by a note executed by Davis on July 11, 1951.

The plaintiff contends that these defenses are not available because it is a holder in due course. The defendant Arnold, asserting that the bank is an immediate party to each of the three notes and that therefore they are subject to all defenses and equities, challenges the soundness of the bank's contention that it is a holder in due course and further asserts that the bank took the three notes in bad faith and with notice of Davis' lack of authority.

1. The Bank As Holder In Due Course

Since the notes were not negotiated or transferred to a third party, the question presented is whether under the Negotiable Instruments Law, Sections 27-1-1 to 27-4-6, A.C.L.A.1949, the payee of a negotiable instrument can be a holder in due course. The authorities are split on

this question, Beutel's Brannon, Negotiable Instruments Law, 7th Ed., 675-691, Sec. 52; Annotation, 169 A.L.R. 1455. At common law a payee could be a holder in due course if he was a bona fide purchaser for value and without notice of any infirmities in the instrument. 4 Williston & Thompson, Contracts, 3329, Sec. 1157. This has influenced some courts into holding that the Uniform Negotiable Instrument Law effected no change. Liberty Trust Co. v. Tilton, 217 Mass. 462, 105 N.E. 605. As a matter of pure logic, it cannot be held that a payee can be a holder in due course under the Negotiable Instruments Law because the delivery of a negotiable note to the payee is termed an "issue", Section 27-4-2, A.C.L.A.1949, and in order to transform a holder into a holder in due course, the instrument must be negotiated to him, Section 27-1-72, A.C.L.A., 1949. The better reasoning is that a payee may be a holder in due course if the requisites of that status are otherwise satisfied. Section 27-1-72, A.C.L.A.1949. The only requisite the existence of which is challenged in this case is that of good faith. Whether the plaintiff can satisfy this requirement depends upon the extent to which the knowledge of Maze, its manager, is imputable to the plaintiff.

2. Imputed Knowledge Doctrine

The well-established principle that the knowledge of the agent is the knowledge of the principal as to acts done by the agent within the scope of his authority and in furtherance of the principal's business is of course applicable to banking corporations and their agents. The knowledge of a bank officer which will be imputed to the bank is knowledge concerning matters within the scope of his authority that he is under a duty to communicate to the bank. American Surety Co. v. Pauly, 170 U.S. 133, 18 S. Ct. 552, 42 L.Ed. 977.

The exception to this rule, known as the "adverse agent doctrine", does not seem applicable to this case. The gist of this exception is that the knowledge of the agent will not be imputed to the principal if the agent is engaged in fraudulent activities which it is necessary to conceal in the perpetration of the fraud, Schram v. Burt, 6 Cir., 111 F.2d 557. But even if the adverse agent exception would seem to be applicable to a situation of this kind, the sole actor qualification, Munroe v. Harriman, 2 Cir., 85 F.2d 493, prohibits the application of the exception where, as here, only one agent of the bank deals with the third party. The apparent basis of the qualification is estoppel. The Courts refuse to permit a bank to recognize the agency of its officer for the purpose of accepting the benefit of a note obtained through him and at the same time deny the knowledge the officer had when the note was made, State Bank of Pamplin v. Payne, 156 Va. 837, 159 S.E. 163. The same result may be reached on the theory of ratification, Muentzer v. Los Angeles Trust & Savings Bank, 7 Cir., 3 F.2d 222. The bank cannot sue on the notes and

then attempt to escape the imputed knowledge rule by setting up the fraudulent scheme of its officer, Goldstein v. Union National Bank, 109 Tex. 555, 213 S.W. 584.

In order to avoid the imputed knowledge rule, the agent's interest must be so adverse to that of his principal as to virtually destroy the agency relation. In the case at bar, since it cannot be said that such a condition existed, Maze's knowledge of Davis' lack of authority to make notes on behalf of the firm is imputable to the bank. It necessarily follows that plaintiff is not a holder in due course because it took the three notes in bad faith, and that the defendant Arnold is not liable because Davis had no authority to execute negotiable paper binding on the partnership, Section 28-1-21, A.C.L.A.1949.

It would appear, therefore, that the defendant Davis is the only person liable on the notes in controversy, Sections 27-1-20, 27-1-31, A.C.L.A. 1949; Cf. Catlett v. Hawthorne, 157 Va. 372, 161 S.E. 47, Annotation, 4 A.L.R. 258. But the plaintiff asserts that the note of July 12, 1951, executed by Davis renewed the note of October 24, 1950, executed by defendant Arnold, and hence the question as to the effect of a renewal note upon the original is raised.

3. The Note Of July 12, 1951

Assuming that the plaintiff was a holder in due course of the note executed by the defendant Arnold on October 24, 1950, did it lose that status by taking the note executed by Davis on July 12, 1951? The answer to this question depends largely on whether the bank accepted the renewal note as payment of the original, Annotation, 35 A.L.R. 1294. As to the nature of such a transaction, the views of bankers and lawyers diverge. The bankers think in terms of payment, whereas the lawyers see only the continuation of the original debt in another form. It has been said that such transactions should be regarded as payments because the banks so regard them, Childs v. Pellett, 102 Mich. 558, 61 N.W. 54, but where a note is renewed by the original parties it is not perceived how such a transaction could constitute a payment of the debt. Molsons Bank v. Berman, 224 Mich. 606, 195 N.W. 75, 35 A.L.R. 1289. Where, as here, however, the renewal is made by a different party and the bank informs the original maker that she is no longer liable, the intention to accept the renewal note as payment can hardly be open to doubt.

Strictly speaking, Davis' note of July 12, 1951 for $5,100 was not a "renewal", but a substitution of his obligation for that of the defendant Arnold, Grace & Co. v. Strickland, 188 N.C. 369, 124 S.E. 856, 35 A.L.R. 1296; Childs v. Pellett, supra. By accepting Davis' note as payment of the defendant Arnold's obligation on her note of October 24, 1950, the plaintiff released her from further liability. While not a conclusive cir-

cumstance by itself, it is significant that the plaintiff promptly surrendered the note of October 24, 1950 to the defendant Arnold.

I am of the opinion, therefore, that the plaintiff is entitled to recover only against the defendant Davis on the notes sued upon.

In view of the conclusions reached it is not necessary to determine the validity of the defendant Arnold's exhibit "G" as a release.

4. The Counterclaim

The defendant Arnold's cross-complaint is based upon breaches of the contract of deposit. It is undisputed that it was agreed between the plaintiff and the defendant that checks would be drawn on the partnership account only in payment of partnership obligations, and that they would be signed by Davis and counter-signed by Maze. The requirement of a counter-signature was for the protection of defendant Arnold. Not only did Maze agree to this, but on several occasions, when defendant Arnold discussed with him her apprehension over the conduct of her copartner, he not only pretended to be protecting her interest at the very time when the fraudulent scheme was in operation, but suggested that she rid herself of worry by "leaving everything up to him".

Plaintiff, however, contends that there was no breach of contract, but rather a tort sounding in conversion. But it must be conceded that in honoring checks not counter-signed by Maze, the plaintiff breached the contract as well as committed the tort of conversion. In this situation, the defendant could waive the tort and sue on the contract. Felder v. Reeth, 9 Cir., 34 F.2d 744. That a deposit may be the subject of contract between the bank and the depositor is settled. And the depositor may impose conditions upon the withdrawal of his funds, the failure to observe which constitutes a breach on the part of the bank for which it is liable, Henderson v. Greeley National Bank, 111 Colo. 365, 142 P.2d 480, in damages. In either event, the amount recoverable would be the same. Main Belting Co. v. Corn Exchange National Bank, 325 Pa. 168, 188 A. 865. Plaintiff's contention, therefore, that the counterclaim will not lie under Section 55-5-52, A.C.L.A.1949, because it is not a contract claim which was in existence at the commencement of the action is without merit not only for the reasons stated, but also because Rule 13, Fed. Rules Civ. Proc., 28 U.S.C.A., supersedes the section relied upon to the extent of any conflict between them, Kuenzel v. Universal Carloading and Distributing Co., D.C., 29 F.Supp. 407.

It may well be that defendant's counterclaim was compulsory rather than permissive, but aside from the fact that it would appear to have arisen out of the same series of transactions as gave rise to plaintiff's claim, and that all necessary parties are before the Court, it is not necessary to decide this point.

Plaintiff further contends that the counterclaim is premature because there has been no accounting between the partners. There is considerable plausibility to this contention, but it will not bear analysis. It is undisputed that checks at least in the total amount of the counterclaim were drawn upon and charged to the partnership account, in violation of the terms of the contract of deposit and for other than partnership purposes. Maze's counter-signature not only was required by the contract, but this requirement of a counter-signature was for such a diversion of partnership funds. I conclude, therefore, that the defendant Arnold, the only litigating defendant, is authorized to interpose such a counterclaim, and that the plaintiff has no standing to demand an accounting before it can be held liable for its wrongful acts.

Conclusion

I am of the opinion, therefore, that the plaintiff is entitled to recover the amount sued for only from the defendant Davis in his individual capacity, and that the defendant Arnold is entitled to recover on her counterclaim.

TRUST DECISIONS

Digest of current decisions pertaining to the law of trusts, wills, estates, descent, distribution and corporate fiduciaries

Agreement on Bank Signature Card Controlling in One State, Not in Another

In re Furjanick's Estate, Supreme Court of Pennsylvania, 100 A.2d 85

When he was 83 years old, Peter Furjanick took his niece to the bank and changed his individual savings and checking accounts to joint accounts in both their names. The signature cards which both of them signed stated that the accounts were "owned by them jointly with the right of survivorship" and that "upon the death of either the balance . . . shall belong to the survivor of them." The cards also contained an agreement that this arrangement was not revocable except by written notice to the bank signed by both depositors. Under these circumstances the Pennsylvania Supreme Court ruled that oral testimony of the bank president who handled the transaction was not admissible in evidence to show that Peter Furjanick had not intended to make a gift to his niece. The contract on the signature cards was binding and could not be altered in the absence of a showing of fraud, accident or mistake, none of which were present here.

In re Kellison, Surrogate's Court, New York, August 27, 1953

In this case decedent and a friend signed a signature card which stated the account was to be "paid to either or the survivor" and "on the death of either of us, the funds remaining on deposit shall be the sole and absolute property of the survivor . . ." The card was labelled "Joint Interest Account." The court held that the funds in this account did not belong to the joint owner since evidence showed that the decedent who supplied the funds for the account had not *intended* to create a survivorship account.

The conclusions in these two cases are exactly opposite, the former upholding the sanctity of the written contract, the latter taking into account the intention of the bank's customer as proved by looking beyond the signature card. It is important to note that the depositors in both cases, whether they intended a survivorship account or not, created

joint accounts so someone else could obtain funds to pay bills at a time when the depositor himself might be unable to do this. The fact that this situation occurs so often suggests an obligation on banks to explain to their customers in detail the significance of survivorship accounts.

Corporate Trustee's Deduction for Income Tax Purposes Allowed

New York Trust Company v. United States, United States District Court, S. D. New York, 115 Fed Supp. 661

A New York court decree directed a bank to be a trustee under terms of a compromise settlement with decedent's heirs who had been the executors of the estate. The decree directed the bank as trustee to pay commissions to the executors for their services in administering the estate. The trustee did this and in the year of payment deducted from the trust income, for income tax purposes, the amount of such commissions. When the Commissioner refused to recognize this payment as a deduction, the bank brought suit. The court ruled in favor of the bank, rejecting the contention of the tax authorities that the bank could not make a deduction from *trust* income for payment of expenses which pertained strictly to the *estate* administration.

Registration of U. S. Savings Bonds Not Conclusive of Ownership

Henderson v. Bewley, Kentucky Court of Appeals, December 18, 1953

A huband and wife had their $20,000 savings in a joint account. Without her husband's knowledge the wife used this money to buy ten $1,000 United States Savings Bonds Series E which were registered in her name jointly with her husband, and ten which were registered in her name only. Later, the wife had the bonds transferred into the name of herself and various relatives and then put the bonds in a safe-deposit box she owned jointly with her husband. When she died, the husband refused to give up the bonds. The court ruled in his favor, imposing a constructive trust on half the bonds which it held the wife took fraudulently and declaring the other half of the bonds passed to the wife's estate since she had not made effective delivery of them to her relatives.

TAX DECISIONS

Digest of current decisions pertaining to the law of taxes on banks, trusts, estates and gifts

Bank Prevails in Suit Against Commissioner for Wrongful Assessment

Ballard County et al v. Citizens State Bank of Wickliffe, Kentucky Court of Appeals, 261 S. W. 2d 420

The Kentucky State Tax Commission of its own volition and without notice to a bank raised the valuation for tax purposes of shares of stock in the bank. The Commission did this after an assessment had been made by the local commissioner and approved by the county board of supervisors. The Kentucky Court of Appeals ruled that the bank in a suit of its own could enjoin the Tax Commission from putting the raise in valuation into effect and did not have to appeal the Commission's order since it was void and of no effect.

Cost of Bank Building Determines Depreciation Basis

National Bank of Commerce in Memphis v. Commissioner, 12 United States Tax Court Memorandum Decisions, November 24, 1953

After the bank holiday in 1933 a state bank decided to reorganize and a new national bank was created. The old bank subscribed to the shares of the new bank and paid for them with cash received from the Reconstruction Finance Corporation to which the shares were pledged together with the bank building and fixtures. The new bank rented facilities from the old bank until 1937 when it purchased the building and fixtures for $950,000, the price being paid by check directly to the R.F.C. which released its lien on these assets. Some years after this acquisition the new bank claimed it should be able to compute its depreciation and invested capital for tax purposes on the adjusted basis of the building and fixtures as calculated when they were in the hands of the old bank rather than on the $950,000 purchase price. The Tax Court refused this contention. It based its decision on findings that

(1) the assets were not acquired "in connection with the reorganization, (2) this was not an "exchange solely in kind" since the new bank had made payment entirely by check, and (3) the new bank did not acquire the assets "as paid-in surplus or as contributions to capital."

Refund Available to Estates Under 1949 Legislation

Guggenheim, Executor v. United States, United States Court of Claims, December 1, 1953, 53-2 USTC

Many tax refund cases are beginning to appear under the Technical Changes Act of 1949. An important section of this Act is Section 7 which provides that certain transfers of property made in the past are not taxable by reason of the retention by the transferor of a reversionary interest unless the value of such an interest was more than 5% of the value of the property transferred. Relying on this statute, the executors of two Guggenheim estates in New York were recently able to obtain refunds amounting to $36,000 and $28,000 on taxes paid in 1942 and 1944. The Court of Claims ruled that two reversionary interests were not includible in decedents' gross estates under the Technical Changes Act where decedents had jointly created a trust for the lives of their brother, his wife and son with the principal of the trust reverting to decedents or their issue only if the son died without leaving any children.

Land Trust Certificates Taxable in Domicile of Owner

Security Trust Company v. Department of Revenue, Kentucky Court of Appeals, December 18, 1953

The Kentucky Court of Appeals has determined that for purposes of the imposition of *ad valorem* and death taxes, certain Building Trust Certificates, owned by decedent who was domiciled in Kentucky, should be classified as intangible personal property rather than an interest in real estate. The court based its opinion on the fact that the certificates gave decedent none of the usual incidents of ownership of the land but were rather very similar to shares of stock in a company owning real estate.

INVESTMENT AND FINANCE

Edited by OSCAR LASDON

Investment Market and Interest Rate Outlook

IN its annual review, "United States Government Securities and Interest Rates," the Bankers Trust Company of New York notes that the investment requirements of business corporations, homeowners and state and local governments will be lower this year than last. The volume of new corporate security issues is expected to be less than in 1953 while real estate mortgage debt is expected to rise at a slower pace than was witnessed in the year gone by. State and local governments are the only major group of borrowers expected to equal or exceed their new security offerings of 1953.

In this latter category, modernization, expansion and new construction of schools, hospitals, highways, turnpikes and other public facilities are proceeding rapidly, and the voters have demonstrated their approval of continuing high budgets for these purposes. It is noted that projects already under way or scheduled to be undertaken in 1954 indicate that this will be another record year. However, even if the amount of new obligations issued by state and local authorities should increase again, their growth is not likely to offset more than a fraction of the decline anticipated this year in private demands for funds.

On the other hand, the supply of new savings is expected to be maintained close to last year's record peak. Funds held by life insurance companies, mutual savings banks, and savings and loan associations have been growing rapidly in recent years. And while an easing in business activity may have some retarding influence upon the rate of increase, individual savings are expected to be maintained at high levels in the absence of substantial declines in income. Institutional investors may be expected to make further large additions to their investments in 1953.

With requirements for investment funds likely to be less than in 1953, and the volume of funds seeking investment outlets probably increasing almost as much as last year, it is ventured that "economic forces will tend to operate in the direction of keeping bond yields relatively low in comparison with last year."

It is observed, however, that bond yields and interest rates have already declined sharply in recent months in anticipation of a change in investment environment. It is also noted that the prospect of long-term Treasury borrowing — although deferred for the present — will presumably remain a factor in the market and may restrain the upward course of bond prices. "It seems a reasonable expectation,"

declares the Bankers Trust survey, "that the bond market will experience no repetition of the extreme fluctuations that characterized 1953." Nevertheless, until there is evidence of a reversal in the current direction of economic activity, the survey does not anticipate that the authorities would do otherwise than make continued efforts to encourage credit expansion and maintain relatively low interest rates.

Life Insurance Company Investments

The basis for Life Insurance Company investing in common stocks is outlined by H. Everett Woodruff, vice-president in charge of the Investment Department of the New York Life Insurance Company. The justification for such investing, he observes, is furnished by answers to the two following questions:

1. "Is the difference in yield between 3 per cent on a typical bond and 5 per cent on a high-grade stock of material benefit to the policyholders?"

2. "Does the extra return compensate for the difference in the degree of risk and greater volatility of the market values of common stock?"

In answering these questions, Mr. Woodruff points out that a very substantial part of the money employed provides a return that will be compounded semi-annually over a long period of years, probably averaging thirty. This feature of life company investing operations — compounding of interest over a long period — is often overlooked by the ordinary individual. Actuarially, however, it is an important force in the growth of policy reserves.

To illustrate, Mr. Woodruff cites the following examples. One million dollars, invested in a 3 per cent bond maturing in twenty years — with the interest invested at the same rate semi-annually, produces a fund of $1,814,000 at the end of the period. On the other hand, the same one million dollars invested in common stock affording a 5 per cent return, and similarly compounded, provides a total value of $2,685,000 at the close of the twenty-year period. The difference of $871,000 in value represents the result of compounding the 2 per cent differential. Thus, on the assumption that the 5 per cent stock return were maintained for 20 years and were set aside each year in a fund, the market value of the portfolio could decline by 87 per cent before the net value of the fund would be reduced to the same amount accrued by the 3 per cent bond investment. The answer lies in the fact that 3 per cent money takes about 24 years to double itself, whereas it only takes 14 years for 5 per cent money to achieve the same result. Money earning 6 per cent would take only 12 years to double itself.

Obviously, states Mr. Woodruff, this higher yield on equities is of material benefit to the policyholders and is more than adequate to compensate for the difference in the degree of risk and any conceivable decline in the market value of

high-grade common stocks. In this connection, he also notes that life insurance is a growing industry which is seldom, if ever, forced to liquidate holdings at distress prices.

The New York Life Insurance Company has a list of 90 approved common stocks. From this selection it pursues a dollar-averaging purchase plan, and regularly invests the same total number of dollars each month regardless of the market level; investments are made in those stocks providing the desirable yield differential. Mathematically, of course, such a program must yield a higher return than that obtained by investors who purchase an equal number of shares each month.

Investment policy at the New York Life Insurance Company concentrates on the dividend paying prospects of a company, rather than on capital gains. Compounding interest at a high rate is deemed more important in the long run than capital gains. And while the amount of dividends paid is bound to fluctuate somewhat from year to year, studies have shown that the long-term trend of dividends is on an uptrend — rising at the average rate of about 3 per cent annually since 1889 — particularly if applied to a well-diversified and selective list of common stcoks. A life insurance company's program of buying common stocks, Mr. Woodruff emphasizes, should be formulated on the basis of anticipated income rather than on hopes of capital appreciation.

The total of common stocks purchased by the New York Life Insurance Company amounts to roughly $44 million. Of this total, approximately 28 per cent is invested in electric utility shares, 15 per cent oils, and the remainder in a well-diversified cross-section of the country's principal companies and industries. At the end of 1953, these holdings registered a moderate capital appreciation of about 7 per cent, and afforded a handsome dividend return of 5.8 per cent. Allowing for the beneficial treatment accorded dividend income by the Federal Income Tax laws, the return is better than 6 per cent.

The accompanying tables, prepared by Mr. Woodruff, support his thesis.

Number of Years in Which Money Doubles at Different Semi-Annually Compounded Interest Rates

Interest Rate:	3 per cent	4 per cent	5 per cent	6 per cent	7 per cent
Years	23½	17½	14	11¾	10
Value of $1,000 Compounded	1st Yr.	5th Yr.	10th Yr.	15th Yr.	20th Yr.
Semi-Annually at 5%	$1,051	$1,280	$1,639	$2,098	$2,685
Semi-Annually at 3%	1,030	1,161	1,347	1,563	1,814
Difference	$21	$119	$292	$535	$871
Per cent of Original Investment Earned					
By Compounded Interest at 5%	5%	28%	64%	110%	169%
By Compounded Interest at 3%	3%	16%	35%	56%	81%

Bad Debt Reserves

The Internal Revenue Department has amended its regulation with respect to commercial banks' reserves for bad debts. The amended ruling, by modifying the formula governing the computation of "bad debt reserves," will permit the expansion of such reserves to a more realistic level without penalizing the banks tax-wise.

In recent years there has been a considerable growth in loan volume and the banking community has called attention to the fact that reserves, as computed under the old Internal Revenue Department formula, have been inadequate. In a recession, it was predicted, larger write-offs might result than were being provided for. To cure this, the banks are now given the right to use an average of any 20 years prior to the end of 1953 (after 1927) in establishing their loss experience ratios.

The old method of computing bad debt reserves required the use of a moving average experience factor which was determined on the basis of 20 consecutive years, including the taxable year. It should be noted that this method barred the inclusion of bad debt experience in the depression years, 1930 through 1933, for taxable returns filed this year. These were the years in which the banks experienced their greatest percentage of bad debt losses. If so desired, however, banks may continue use of this method and the tax returns for 1954 would be predicated on a 20 year loss experience dating back to 1934.

Under the new rule, banks may not increase their bad debt reserves by more than one-third in the first year, and by more than one-half in the second year. They can set aside the full amount permitted under the new method in the taxable year 1956.

In the memorandum of the Internal Revenue Department, the term "banks" includes incorporated banks and trust companies. Excluded are mutual savings banks having capital stock represented by shares, domestic building and loan associations, and cooperative banks without capital stock organized for mutual purposes and without profit.

Banks may now use an average experience factor based on any 20 consecutive years after the year 1927. This experience factor, "representing the percentage of bad debt losses to loans for the period selected, applied to loans outstanding at the close of the taxable year, determines the maximum permissible addition to the reserve for the year." However, the amounts permitted to be added in each taxable year to the bad debt reserve under this method "may not exceed an amount which will bring the accumulated total in the bad debt reserve at the close of the taxable year to a ceiling equal to three times the average experience factor applied to outstanding loans."

1. The addition to the bad debt reserve for the first taxable year following December 31, 1953 "may not exceed one-third of the difference between the ceiling so com-

puted and the accumulated total in the reserve at the close of the years before the addition."

2. For the second taxable year beginning after December 31, 1953, the addition to the bad debt reserve "may not exceed one-half of the difference so computed and the accumulated total in the reserve at the close of the year before the addition."

While there has been a sharp growth in loan volume in the post-war years, the 20 year bad debt ratio has been declining, due to the elimination of the depression years from the average.

Savings Banks Investments

Recently enacted amendments to the New York State banking law will allow savings banks more leeway for investing in revenue secured bonds of state and local governments. One amendment qualifies, as legal investments, high-ranking municipal obligations secured by revenues for electricity, gas, water or sewerage service.

Another amendment, technical in nature, pertains to the "prudent man" section of the banking law and now makes it possible for thrift institutions to purchase the revenue bonds of any local government agency, regardless of the service rendered by the issuing authority. Like stock purchases, however, such investments are restricted to an amount not exceeding the surplus and undivided profits of the investing institutions.

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Under his jacket

Are you proud that he has everything he needs as he starts the adventure of each day at school? Be prouder still of something hidden under his trim jacket—the stout heart that sends him off unafraid and eager.

This, too, you have given him because your love has made his small world secure. With it, he will build his own security as each challenge comes, in those days when he must stand alone without you.

What finer gift can you give those you love than the gift of security? It is the great privilege in America, where we are free to provide it.

And think, too—this is the way each of us helps build the security of our country, by simply taking care of our own. A secure America is the sum of its secure homes.

Saving for security is easy! Here's a savings system that really works—the Payroll Savings Plan for investing in United States Savings Bonds.

Go to your company's pay office, choose the amount you want to save. That money will be set aside for you before you even draw your pay. And invested in Bonds which are turned over to you.

If you can save only $3.75 a week on the Plan, in 9 years and 8 months you will have $2,137.30. For your sake, and your family's, too, how about signing up today? Or, if you are self-employed, join the convenient Bond-A-Month Plan where you bank.

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